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THE MCCARRAN-FERGUSON ACT AND ANTITRUST IMMUNITY: GOOD FOR CONSUMERS?

HEARING

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WEDNESDAY, MARCH 7, 2007

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Committee met, pursuant to notice, at 9:35 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Patrick J. Leahy, Chairman of the Committee, presiding.

Present: Senators Leahy, Specter, Hatch, and Grassley.

OPENING STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM THE STATE OF VERMONT

Chairman LEAHY. Good morning. When Hurricane Katrina ravaged the Gulf Coast in 2005, it caused unimaginable devastation to the region's residents. My friend from Mississippi and my friend from Louisiana, Senator Lott and Senator Landrieu, have expended every effort to provide help to those who have suffered. They remind us in caucus, on the floor, in the hallways, in the dining rooms of the Senate, and in our offices that the victims are not confined to any one demographic group. The devastation did not care whether you were old or young, man or woman, white or black, or whether you had a political affiliation with either the Republican or Democratic parties.

So today we focus on a subject that has concerned me for some time, a topic that in the wake of the behavior of certain insurance companies in the Gulf Coast has been thrust into the forefront. Our topic is the Federal antitrust immunity of the insurance industry contained in Federal law and whether we should end that so that the insurance industry will operate by the same good competition laws that apply to most other industries. I have never quite understood in today's day and age why they should have this special privilege that other companies do not have.

Our Nation's competition laws can be powerful tools to ensure that consumer welfare is the benchmark for fair and accountable industry practices. Consumers benefit through lower prices, more choices, and better services. Those benefits come from competition.

The antitrust immunity for the insurance industry, contained in the 1945 McCarran-Ferguson Act—I was 5 years old. It is about time we relook at that—raises serious concerns with me. Insurance industry practices affect all of us. If the antitrust immunity is used in a way that distorts the market, that leads to higher prices and poorer service, consumers throughout the country can be harmed.

The potential for insurance industry abuse became clear on the Gulf Coast in the wake of Hurricane Katrina. Residents, who lost so much as a result of the 2005 hurricanes and then were let down by a woefully unprepared Government, were then left to face insurance companies refusing to fulfill their commitments and help rebuild. No one should have to go through what these Americans have been through.

Senator Lott and Senator Landrieu can relate as well as anyone to the difficulty their constituents have had with insurers, insurers that have no problem collecting premiums when times are good, but cannot be found when tragedy strikes. Their States were hit hardest by Hurricane Katrina, and I commend both these Senators for their tireless efforts.

Now that the Gulf Coast is rebuilding, two of the area's biggest home insurers—Allstate and State Farm—are moving out and abandoning the area. A recent editorial in the Times Picayune implored the Louisiana Insurance Commissioner to make sure Allstate's refusal to write new home insurance policies in New Orleans "is not another systematic effort by the company to cancel thousands of policies for which homeowners have been paying premiums."

They are not moving out because the companies have hit on hard times. I believe State Farm last year announced a net income of over $5 billion.

Both Allstate and State Farm want to keep their special status, exempt from the antitrust laws. They want to keep that status, but both—both—rejected my offer to come here today and explain to the Committee why they deserve it. I think they hope that their lobbyists can keep it for them and they will never have to tell the public why they deserve it.

The bottom line is right now we do not know what anticompetitive acts insurers may be engaging in because the antitrust immunity insurers enjoy acts as a curtain that hides their activity from Federal antitrust authorities.

The Insurance Industry Competition Act that I have introduced with Senators Specter and Lott and Reid and Landrieu would pull back that curtain to give the Department of Justice and the Federal Trade Commission the authority to apply our Federal competition laws to insurance companies.

Our antitrust laws are about good competition policy. Competition is good for consumers; it is actually good for our economy. It is the cornerstone of our economic system. Insurers may object to being subject to the same antitrust laws as everybody else, but if they are operating in an honest and appropriate way, they should not have anything to fear.

So I hope that this hearing will spark a serious, thoughtful debate about insurance industry practices—those that benefit consumers and those that do not. Insurers often say that their behavior is pro-competitive. Well, if that is true, they should have been willing to come in and testify, and application of the antitrust laws should not be controversial. Under our Federal antitrust laws, procompetitive behavior is encouraged. It is time to pull back the curtain of immunity and let the light shine in.

Senator Specter?

STATEMENT OF HON. ARLEN SPECTER, A U.S. SENATOR FROM THE STATE OF PENNSYLVANIA

Senator SPECTER. Thank you, Mr. Chairman. I am glad to see the Committee moving ahead this year to act to repeal McCarran-Ferguson. Legislation was introduced last year. We had a hearing last year. We made some progress. And with the intervening events on Katrina and what has happened in the Gulf States, there is additional ammunition and facts to support repeal of McCarran-Ferguson. And I join you, Senator Leahy, in welcoming our distinguished colleagues, Senator Lott and Senator Landrieu.

The McCarran-Ferguson law provides that there will be antitrust exemption where insurers are subject to State regulation. But it continues that exemption even though there is, in fact, no State regulation, and that has left an enormous void. The situation in New York with respect to the Marsh, McLennan case and what has happened in the Gulf States provide ample evidence of anticompetitive activities, collusion, and violations of the antitrust laws, which ought to be subject to Federal prosecution.

The legislation this year eliminates two of the safe harbors, which was in the legislation introduced last year, and I would be interested in any comment by the insurance industry, if they have it, with respect to those two safe harbors. We know that the legislation introduced by Congressman Brooks in 1994 fell under the weight of almost 50 State harbors. But the legislation leaves latitude for the Department of Justice and the FTC to identify practices which are not anticompetitive. But, still, the weight of the Federal Government can be brought to bear. And I think the realities are that unless you have a State like New York with the resources of the Attorney General and the initiatives of an Attorney General like Attorney General Spitzer, this is not a matter that ought to be left to the States. Simply stated, too important.

So I am glad to see the Committee moving forward. I hope we can get this legislation to the floor, enact it, and work with the House to pass some effective antitrust legislation to enable the antitrust laws to go forward without this exemption.

I am going to have to excuse myself for a few minutes. We have the county commissioners from Pennsylvania in town today, and the corridor and the anteroom is blocked off with quite a number of my constituents.

Chairman LEAHY. I wondered who all those people were.

Senator SPECTER. I know that my colleagues, Senator Lott and Senator Landrieu, will understand that temporary priority.

Thank you.

Chairman LEAHY. Thank you.

Senator Lott, of course, is the Deputy Republican Leader in the Senate, he has been the distinguished Majority Leader of the Senate, and he is one of the leaders of the Republican Party. Senator Landrieu is the senior Senator from Louisiana. She is considered in our caucus a leading voice on this whole question of how we respond to the thousands of constituents whose homes were damaged or destroyed by the hurricanes and now nearly 2 years later are struggling.

What I am going to do is go by seniority. We will ask Senator Lott to speak first, then Senator Landrieu to speak, and then if either of you after you speak care to join us up here on the dais, please feel free.

Senator Lott?

STATEMENT OF HON. TRENT LOTT, A U.S. SENATOR FROM THE STATE OF MISSISSIPPI

Senator LOTT. Thank you, Senator Leahy.

First, a bit of Whip work. I understand that the votes we had been told would occur at 10 o'clock have been moved to this afternoon.

Chairman LEAHY. That is right.

Senator LOTT. So we have a little more latitude there, thank goodness.

I want to begin by thanking you, Mr. Chairman, for scheduling this hearing. While there was a hearing last year, I do not think it got quite as much attention or as much interest as it has developed over the past few months. But you have taken up this issue with courage and enthusiasm, and we do appreciate that very much.

I have visited with Senator Specter several times over the last year about this subject. The two of you are experts in this area, and you have been talking about your concerns in this area before. And now is the time where we ask ultimate questions and actually act. So I thank you very much for providing us this forum.

I do want to say what a pleasure it is to be here with my colleague from Louisiana. When you bleed together, you form a bond that, you know, nothing can interfere with. And we have stood together, we have fought together, we have worked together to try to help our constituents that were devastated by the most cataclysmic natural disaster in the history of our country, Hurricane Katrina. We have worked together, and the cosponsorship of this bill is symbolic of how we have approached this. This is not an issue that is partisan or philosophical, and you do not have to be a lawyer to ask questions about how this happened and what does it really mean and how does it affect people that need help.

I want to note that there is a homeowner here—I am sure Senator Landrieu got him here—Michael Homan from New Orleans, and he is going to tell his personal story. We are fellow slab owners. It is a strong association that has been formed. And I think it will be interesting to hear his story.

You know, I did not come at this issue from the standpoint of a plaintiff lawyer or somebody that had it in for the insurance industry. I did not, and I still do not. All I want is for them to do the right thing and to properly pay people for the insurance coverage that they had.

I could go on a long litany of questions and concerns, disappointments, hurt, and horror that I have found since Hurricane Katrina. I had all of my insurance for over 50 years with State Farm, and when I practiced law, I practiced law with a predominantly insurance company defense firm. But somehow along the line there, I missed the point that McCarran-Ferguson actually gives an exemption from our antitrust laws to the insurance industry. And as I witnessed the behavior of the industry in their response to Katrina, which until this day continues, even though there have been some fits and starts, some indications maybe they are going to do more, and denials that there was any kind of collusion or that there is any kind of price fixing, I got more and more curious about the history, the rationale, and the wisdom of such a broad exemption from Federal oversight.

So I took the time to go back and look at it, like any semi-good lawyer ought to. How did this happen? And I found that until 1944, regulation of business of insurance resided securely with the States based on the rationale that this business did not meet the legal definition of "interstate commerce." That year, 1944, the insurance industry was turned on its head by a Supreme Court decision in the case of *United States* v. *South-Eastern Underwriters Association*. By signaling that the business of insurance is interstate commerce, the case brought about a knee-jerk reaction from Congress in a bill that would eventually be known as McCarran-Ferguson.

Soon after that decision, Senators McCarran and Ferguson introduced a bill that within just 2 weeks and without any hearings and without any significant debate—basically no debate—passed the Senate. The House passed a similar measure with little debate. A review of the Congressional Record shows clearly that the intent of both Houses was to provide only a temporary moratorium rather than a permanent exemption.

It was while the bill was being discussed by the conference Committee that a seemingly innocuous phrase was inserted. It was this modification—not in either the House or the Senate versions of the bill—that, when judicially interpreted, turned a temporary moratorium into a permanent exemption.

The House approved the conference report without debate. The Senate, in contrast, finally woke up and debated the conference report for 2 days. Again, the record of the debate clearly shows that a permanent exemption was not the intent of those who voted for its passage.

So clear was the intent that President Roosevelt, upon signing the bill, stated the following in the press release: "After a moratorium period, the antitrust laws...will be applicable in full force and effect to the business of insurance...."

So what happened? The problem resides in the interpretation of that phrase, "regulated by State law." Under the McCarran-Ferguson Act, insurers are exempt from Federal antitrust scrutiny as long as they are regulated by State law. Courts have interpreted this phrase to require only that State regulators have jurisdiction over particular conduct, regardless of whether that authority is ever exercised.

Now, here is what I found the problem is. You know, when I came to Washington, I guess I was pure in a lot of areas. As the years have gone by, I have found I am not pure in any area because I find that there is always another side to the story. There is a colorization. Yes, I think State insurance commissioners have a primary role. I do not want, you know, insurance regulation just to be taken over by the Federal Government. But I have also found this. Insurance commissioners are in a terrible quandary. If they do not allow the insurance companies to jack up their rates 200 percent, 400 percent, or endlessly, they run the risk of the company, whether it is Allstate in some States or State Farm in my

State, saying, “Hey, we are out of here. We are not going to provide property and casualty insurance. Oh, but we will continue to pick off that nice plum auto insurance and commercial insurance.” And the insurance commissioner is in a real difficult position.

But it goes beyond that. You know, antitrust laws. Shouldn't every corporation in America have to comply with that? How do we make sure that there is not price fixing or collusion or anticompetitive conduct of one kind of another? There should be some Federal role here.

I cannot for the life of me understand why we have allowed this exemption to stay in place so long. If there is no problem, then what is their concern? I have been surprised by their reaction to this, saying “You cannot possibly do this.” And, of course, what they are going to do is often what happens. The big guys are going to call the little guys in my State and tell them, “Wait a minute. The ones that are going to be hurt by this are the little insurers. They need this rate information.”

Mr. Chairman, I know you wanted us to limit our time, and I do not want to get too carried away because I get so angry and so passionate about what I have experienced here, and I have been so disappointed by the response of an industry when we needed them the worst. And I found there are many problems in the law, and I am going to do my best to find a way to fix as many of them as we can—not for myself. They even, you know, had the temerity to say, “It is just because you are mad about your house.” Yeah, I am. But the Good Lord made sure I lost my house so I would feel the pain of everybody else that did. Thirty-seven thousand people in my State were devastated by this hurricane, and many more injured, not to mention those in my neighboring State of Louisiana that continues to have terrible problems because they had a flood. We had a hurricane.

[The prepared statement of Senator Lott appears as a submission for the record.]

Chairman LEAHY. Well, Senator Lott, I know your concerns. You and I had the privilege of representing the United States overseas in the last few weeks. We traveled together, and we had long discussions of it. I know how passionate you feel, and I appreciate you being here.

Senator Landrieu, would you please?

STATEMENT OF HON. MARY L. LANDRIEU, A U.S. SENATOR FROM THE STATE OF LOUISIANA

Senator LANDRIEU. Yes, Mr. Chairman. I am pleased to join my colleague Senator Lott. He and I have fought many battles together, and won more than we have lost, thank goodness, over the last 18 months. And we intend to win some more for the people that we represent. Because as both of us have said time and time again, this Government was caught flat-footed with very limited response to the greatest natural disaster to hit the United States. And we need to fix many different aspects of that response.

But we are here this morning to talk about one aspect that needs serious fixing. Mr. Chairman, there is an insurance crisis along the Gulf Coast and probably over the Atlantic Coast, if not in the whole Nation. In New Orleans today and in parts of South Louisiana and Mississippi, even people that might have a plan and money to rebuild cannot do so because they cannot either get or afford insurance for the rebuilding.

So the billions of dollars that the Federal Government has sent down to the States, all the efforts that the States and the local governments are making, are put at risk because of this real and serious insurance crisis. It needs to be addressed, Mr. Chairman, not just in the courts where justice may come, but come quite slowly, and, unfortunately, too late for many. Justice needs to be found here in Congress through the repeal of this Act, if it was unintended, as Senator Lott stated, or through other actions of the Banking Committee and others to give people real relief.

Mr. Chairman, this is a crisis. I have recently heard of one company that has raised premiums by 145 percent. In Orleans and Jefferson Parish, it is not unheard of for carriers to be raising rates by 50 percent. It is not just homeowners who are at risk, all 250,000 who have lost their homes. But, Mr. Chairman, it is our shopping centers, our commercial sector that is having difficulty finding insurance. And if they cannot find insurance, the rebuilding is slowed down and people's lives and fortunes and futures are put at risk. This insurance crisis right now goes to the heart of rebuilding, and Congress does have a role.

And so I want to thank you, Mr. Chairman, for calling this hearing. Perhaps repeal of this statute is a way to move forward, and there are other options at other committees. But I want to make just three brief points.

I know that some of my critics say, "Senator Landrieu, all you ever worry about is what the Federal Government can do or what governments can do to help people in crisis." Now, I will say that I am guilty of believing that Government should be bold and strong—not big and wasteful, but bold and strong. But I also believe the private sector should work, and at the heart of the private sector working is private insurance.

Mr. Chairman, the Flood Insurance Program that we have only covers up to $250,000 worth of damage. Can I say again that there were homeowners that had homes worth $1 million, $750,000, $500,000. This is not unheard of in our middle-class communities to have homes of $350,000, $400,000, and $500,000. Our flood insurance has not kept pace with this, so people that even if they had flood insurance, they did not have proper coverage.

Without the right kind of private sector insurance and the right kind of, I guess, government-regulated flood insurance, our people have no chance of a full recovery after this catastrophic disaster or in the future.

So I cannot tell you how important it is for us to unturn every stone where we might find a solution. There is urgency about this problem, and I stand shoulder to shoulder with my colleague from Mississippi until we find a solution to the people along the Gulf Coast.

This is, as we have said, America's only energy coast, Mr. Chairman. This is not a coast the country can do without. And without real and meaningful and serious insurance reform, our recovery is at risk. There will not be anybody there to run the pipelines. There will not be anybody there to produce the oil and gas, because we will not be able to live anywhere near this coast, and that is not fair to the people who have lived here for over 300 years.

So I thank you for your attention, and as you know, I am cosponsoring several other bills. But I really appreciate the attention of this Committee, and I will be pleased to stay for a few minutes Thank you, Mr. Chairman.

Chairman LEAHY. Well, thank you, and I would invite both of you to come join us up here. And I realize you both have other things to do, so feel free to stay as long or as little time as you would like.

[The prepared statement of Senator Landrieu appears as a submission for the record.]

Chairman LEAHY. We will just take a moment here while we put the other names out. I will just tell you who is going to be appearing.

We are going to have Dr. Michael Homan, who is an associate professor of theology at Xavier University in Louisiana, and he and his wife had moved to New Orleans and purchased a home 6 years ago. The home was severely damaged from the winds of Hurricane Katrina and the flood waters that remained in their house for 2 weeks after the levees failed. Dr. Homan is now engaged in a legal battle with Allstate Insurance Company.

We have J. Robert Hunter, who is currently the Director of Insurance for the Consumer Federation of America. He comes before this Committee with a wealth of knowledge of the insurance industry. In the past, he has served as the Commissioner of Insurance for the State of Texas, as the head of the Federal Insurance Administration in both the Ford and Carter administrations, and is President and Founder of the National Insurance Consumer Organization.

Governor Racicot, the former Governor of the State of Montana, is well known to all of us here. He began his tenure as President of the American Insurance Association August 1, 2005. He had before that experience in both the public and private sectors, joining AIA from the law firm of Bracewell and Giuliani where he had been a partner in the government relations strategy section. In addition to serving as Governor of Montana, he served as a special prosecutor and Attorney General for the State of Montana, which, of course, with a number of former prosecutors on this Committee on both sides of the aisle, we are always delighted to see.

Commissioner Voss is from the Iowa Insurance Division, and I wonder, Senator Grassley, if you might take over and introduce her. You know her best.

Senator GRASSLEY. I sure would like to do that.

I know, from working with Susan very closely on a Federal program she administers called the Senior Health Insurance Information Program, how hard she and her staff worked to help us get Part D put in place, Part D of Medicare. I thank you very much for that.

Obviously, her major responsibilities are helping the insurance industry and governing the insurance industry in the State of Iowa. She has been with the division since 1993. In 1999 she was appointed First Deputy Commissioner for the Iowa Division, and the Iowa Insurance Division is our Department of Commerce in

State government there. And she has now been the Iowa Insurance Commissioner since January 1, 2005. So I welcome you.

And I am also a good friend of Bob Hunter's. I do not know whether he wants to admit that or not.

[Laughter.]

Senator GRASSLEY. Actually, I have known him longer than I have known Susan.

Chairman LEAHY. And he is good friend of mine. That may kill you back in Iowa, but—

Senator GRASSLEY. Well, anyway, I welcome you, too, Bob. And I have been in the Governor's office in Montana when you were still Governor, so I am glad to have you with us as well.

At 10 minutes after the hour, I am going to leave because I have a news conference with Senator Thune that I have to go to, but I will hopefully be back after that.

Chairman LEAHY. Would you all please stand and raise your right hand? Do you swear that the testimony you are about to give to this Committee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. HOMAN. I do.

Mr. HUNTER. I do.

Mr. RACICOT. I do.

Ms. VOSS. I do.

Chairman LEAHY. Let the record show that all were sworn in, which is customary here, and I am going to limit your opening statements to 3 minutes each. That is to give us time for questions, only because we have a joint meeting of the Congress this morning which will pretty well wipe us all out. Your whole statement, however, will be made part of the record.

Mr. Homan, please. Press the little button.

STATEMENT OF MICHAEL M. HOMAN, HOMEOWNER, NEW ORLEANS, LOUISIANA

Mr. HOMAN. Chairman Leahy and members of this Committee, thank you for holding a hearing on this important issue.

Like many in the Gulf Coast region, my family's lives were forever changed by Hurricane Katrina. But what brings me here today is the second personal tragedy that my family and I have suffered since Katrina because of the bad faith of Allstate Insurance over the past 18 months.

My wife, two children, and I currently live in a FEMA trailer in the front yard of our collapsing home in New Orleans as we continue to battle with Allstate over our insurance claim. We insured everything we had with Allstate. This included wind and flood. They cashed every check we gave them. We slept well every night thinking we were adequately insured with the self-designated "good hands" people, but we were not in good hands.

I was inside our house during Katrina, and it was like being on a large boat rocking back and forth from the wind gusts. The winds ultimately racked our two-story house so that now it leans severely. The house next door to ours is leaning in the same direction.

After the levees failed, flood waters covered the first 3 feet of our house, and this water remained for more than 10 days, damaging the foundation and piers, causing our house to lean even more. Right now as I speak, our home is in danger of falling onto our neighbor's house.

We filed a claim for wind and flood with Allstate the day after Katrina. We expected things to move along quickly, but we were wrong. We called Allstate every day for several months, and we wrote them frequently. But we rarely received answers. They played a shell game with us, providing us with ten different agents through this ordeal, and it took 9 months to even get a wind adjustor to come to our house.

The third flood adjustor we had arrived in October of 2005, and right away he could see our house was leaning, and he ordered an engineer from Allstate to assess whether it was racked from wind or flood. We did not care either way. Everybody told us they would say it was racked from flood and they would pay us. You know, either way, we did not—just so we had enough money to fix our house. But then we waited and waited, and the engineers never showed up. We were told that everything hinged on that report, and we were told to be patient.

Several months passed, and we were running out of savings. We had to pay for our rent on top of our mortgage. We were insured so that Allstate would pay us additional living expenses should our house be destroyed or be in an unlivable state like ours was. But Allstate said they would not pay any of that until they received the engineer's report. Because of our financial situation, my family and I were forced to move back into our structurally unsound home and spent 9 months living in the upstairs portion that did not flood.

Finally, in February of 2006, after 6 months of phone calls and letters, two men from Haag Engineering arrived at our house. They spent 15 minutes there taking pictures, and then they left. We did not hear anything until May of 2006 when I received a letter from Allstate saying they were denying our claim for structural damage because of the Haag engineers' report. So we were terrified. We had a $150,000 mortgage for a property that was worth now about $30,000. We thought about declaring bankruptcy, but we did not want to live with bad credit.

Fortunately for us, the Haag engineers' report is full of huge mistakes. They have pictures that do not belong to our house. They call our house "the Wilson house." You know, it was ridiculous. They said it was not windy enough during Katrina to make a house lean, even though lots of houses in our neighborhood have collapsed.

My story is not unique. I have heard from dozens of other people in the same situation as us that the insurance company gets an engineering firm to write the report they desire, and then they deny the claim. And the insurance company will not be liable because they relied on expert witnesses, so-called expert witnesses.

I see I am out of time, so I will stop there.

[The prepared statement of Mr. Homan appears as a submission for the record.]

Chairman LEAHY. Well, thank you, and I apologize for limiting the time but, otherwise, we would not be able to have the hearing today.

Mr. Hunter?

STATEMENT OF J. ROBERT HUNTER, DIRECTOR OF INSURANCE, CONSUMER FEDERATION OF AMERICA, WASHINGTON, D.C.

Mr. HUNTER. Thank you, Mr. Chairman. I am here on behalf of Consumer Federation and several other consumer groups, including Consumers Union, nine groups in all who are offering our enthusiastic support of S. 618 today.

In the last 3 years, the property/casualty insurance industry realized record profits despite all these hurricanes. Over the 3 years, the profits were $157.4 billion, equal to a profit of approximately $525 for every American. At the same time, we have heard what is going on on the coast, access of insurance being denied and the claims not being settled.

Coastal residents have suffered as a result of the antitrust exemption. Like all of America, the exemption allows anticompetitive practices, such as joint price setting that impacts the majority of the rates for many companies affiliated with cartel-like rate bureaus; joint policy language development by these bureaus; use of the same or similar low-ball claims settling computer programs by many companies, and other practices that would be illegal if it were not for the exemption of McCarran.

In the Katrina situation, several of these practices did specific harm. First, claims were being settled under the outrageously unfair anti-concurrent-causation clause adopted simultaneously by many insurers through the actions of rate bureaus.

Second, ISO, the rate bureau, signaled that the market was overexposed on the coastline. Days later, 150,000 homes were dropped, and the exodus continues today.

Third, the unregulated rate guidance organization, Risk Management Solutions that does its modeling of hurricanes, changed its model, causing home insurance rates to jump 40 percent on the Gulf Coast and by 30 percent up to Maine. The new model breaks the promise of the use of a long-term model to achieve stable prices and instead uses a mere 5-year time, under the theory that it is a high hurricane activity and they have to raise prices. It is shocking, it is unethical, that scientists have, under pressure from the insurers, which is obvious, completely changed their minds, all at the same time after 10 years of assuring everybody that the models they were using were scientifically sound. I encourage you to look at the revelations in the Tampa Tribune where some of these experts they used now say that it was not a scientific effort.

Finally, many insurers use identical or similar claims processing systems that are designed to systematically underpay claims. These systems have been recommended by common consultants and sold and maintained by common vendors—all the earmarks of possible collusion to underpay claims. The President and Congress ought to look into it.

Consider this startling statement from the President of the Association of Property/Casualty Claims Professionals: “I was ashamed. It was as if some small group of high-level financial magnates decided that the only way to save the industry’s financial fate from this mega disaster was to take a hands-off approach, hide behind the waves, and the flood exclusion. The carriers behaved as one.”

This is from the President of the Property/Casualty Claims Professionals.

I have run out of time, too.

[The prepared statement of Mr. Hunter appears as a submission for the record.]

Chairman LEAHY. Again, I apologize. And I have read the statements. They will be part of the record, and I do appreciate that. Governor Racicot?

STATEMENT OF MARC RACICOT, PRESIDENT, AMERICAN INSURANCE ASSOCIATION, WASHINGTON, D.C.

Mr. RACICOT. Good morning. Thank you.

Last June, I testified before this Committee on McCarran, and I appreciate the opportunity to be here again this morning to do the same thing, and I would like to focus on three critical issues—briefly, obviously: first, McCarran's role in balancing insurance regulation and antitrust enforcement; second, the scope of McCarran's limited Federal antitrust protection; and third, the downside of McCarran repeal.

Congress enacted McCarran in 1945, and it did two things: it delegated to the States the authority to regulate and tax the business of insurance, and it withheld application of Federal antitrust laws to the extent that States, in fact, regulated the business. So McCarran authorized the States to determine how the balance of State regulation and Federal antitrust enforcement would be drawn, but did so on the condition that the Federal antitrust laws would apply to the business of insurance to the extent that a State did not regulate the industry.

Thereafter, States weighed the benefits of broad regulation against open-ended antitrust litigation and decided to strike the balance in favor of comprehensive regulation. They all adopted pervasive insurance regulatory schemes, including numerous antitrust type protections. Not surprisingly, that same balance has been adopted for federally regulated banking and securities industries.

In achieving that balance, the Federal courts have held that antitrust scrutiny is inappropriate where an activity is carried out in conformity with a regulatory system established by Congress. If that were not the case, chaos would rule. Private antitrust litigation constantly would battle regulatory systems for primacy, creating enormous uncertainty for businesses and consumers to no one's benefit.

Thus, McCarran strikes the same balance of regulation versus antitrust enforcement for insurance that exists for federally regulated banks and securities firms, and without McCarran, that balance would be undercut.

There is a persistent misunderstanding about the nature of McCarran's protection, and I hope to make my testimony very clear on this point today. McCarran is less of an insurance antitrust exemption and more of a guide for the States in balancing the regulation and antitrust enforcement roles for the business of insurance. Equally important, McCarran antitrust protection only applies to the business of insurance to the extent that it is regulated by State law. It does not apply to activities that constitute boycott, intimidation, or coercion, whether or not those activities are regulated, and it does not provide any protection from the numerous antitrust provisions in State law.

Which leads to the question of whether Senate bill 618 repealing McCarran's narrow antitrust protection would be helpful or harmful. We strongly believe it would be harmful. The balance between regulation and antitrust enforcement would be destroyed, replaced by an uncertain system that adds another layer of Federal antitrust enforcement in addition to the one that is already there, on top of the State regulatory system. We do not think that is in the best interest of either consumers or the people of this country or the individual States.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Racicot appears as a submission for the record.]

Chairman LEAHY. Well, thank you very much, Governor. Commissioner Voss?

STATEMENT OF SUSAN E. VOSS, IOWA INSURANCE COMMISSIONER, AND VICE CHAIR, FINANCIAL CONDITIONS COMMITTEE, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, WASHINGTON, D.C.

Ms. VOSS. Thank you for inviting me to come here today. I am working with a small group of commissioners at the NAIC to, in fact, review Senate 618, and I want you to know just very briefly that we support the underlying intent of Senate 618 because our No. 1 goal is to protect consumers by enabling investigations to take place. We want to make sure that the consumers are protected from the bad actors, and we would suggest that with our State experience and limited use of the antitrust provisions, we could work collaboratively together as sort of a cooperative federalism to ensure that those bad actors no longer prey on our consumers.

We understand that there are practices out there that need to be reviewed, but we also would caution you that there are examples when we at the State level know that providing information between carriers can be important to our consumers. And we want to make sure that we strike a balance between any regulation that you would see fit with the exemption of this antitrust—with the repeal of this antitrust exemption, that we can continue to seek positive rates for our consumers and protect them as it is important.

We are totally in agreement that we want to protect against offensive conduct. We just want to make sure that whatever types of exemption that you see fit to pass does not impede our continued work with State regulation and to protect our consumers and our industry. We would very much like to continue working with you in a strong dialog to see that whatever is crafted is best for our consumers and our industry overall.

The NAIC is continuing to review Senate 618. In fact, we are meeting in New York City beginning this weekend to further review your proposal, and with your permission, we would like to present you with additional information once we have met this next week.

Thank you.

[The prepared statement of Ms. Voss appears as a submission for the record.]

Chairman LEAHY. Of course, and we will leave the record open for that, and I appreciate that.

Mr. Homan, you know, I am listening to your story, and I am thinking of my own home in Vermont. If something like that had happened, with all the memories of the home, how much it would hurt to lose the home, but even more, how much it would hurt to think I am not going to get the money to rebuild it.

The situation you have described, is this similar to what your neighbors have had? I mean, you must have talked to other people there. Are they facing the same problem in rebuilding?

Mr. HOMAN. Yes. Since Katrina, of course, I have gotten to know my neighbors, at least those who are back, better than ever before. We are working all together. I would estimate that in my neighborhood of Mid-City New Orleans, approximately a third to half the people are back, and you can just go down the line. The people that are back, the insurance company settled with them, you know, in a fair and adequate means, and they were able to rebuild. My neighbor right across the street right now—Steve—is just days away from moving back into his house. And, you know, we are just still waiting. We know once we settle—we have just settled with the Road Home just a couple weeks ago, and we think we will have enough funds to rebuild with that. It will be a little bit short because they canceled our SBA loan because we are getting the Road Home funds.

But, in any case, we think we will be fine. But we will start rebuilding in a month or two, and it is going to take another year. So it is a long time. You know, I have a 6-year-old kid and an 11-year-old daughter who are going through this. So I question my parenting skills a lot of times because of this. But, in any case, you know, I would say a third to half the people are back.

Chairman LEAHY. Thank you.

Mr. Hunter, based on your experience, would Mr. Homan's situation have been resolved the same way if he had been insured by one of the other major property insurers?

Mr. HUNTER. Well, we know, for example, that Haag Engineering was used by more than one insurance company. I am sure Senator Lott can tell you about Haag Engineering in Mississippi, for example, with a different insurance company than Allstate. And so your chances of being in Mr. Homan's situation with a different insurance company is certainly high. Obviously, I think there are some examples that are different, but just being with another insurance company would not assure a different result.

Chairman LEAHY. You have talked about the Risk Management Solutions, RMS, using models, as I understand, to set premium rates that take into account long-range weather disaster predictions and so on, and used to assure there would be no need to raise rates after a catastrophic weather event. Can such a system work for consumers?

Mr. HUNTER. Sure, a long-term modeling system would bring stability. In fact, that was the way it was sold to us when I was working with the State of Florida, working with the academic task force after Hurricane Andrew. We were told that one of the things they had to do was price hurricanes in a new, different way, and they were right. The insurance companies did underprice it before Andrew, and they went to this long-term modeling, and it was sold on the basis that once we have a long-term, say 10,000-year, projection, we will bring stability into the coast. That means big rate increases today.

Then I became Insurance Commissioner in Texas, and they came over and they said, "We have got these new models. You are going to have to double, triple, quadruple the rate." I had to go to my Governor, Ann Richards, and say, "Gee, we have got to double, triple, quadruple the rate, but we are buying stability." Now they have switched to a 5-year model, which is a total, in my view, renege of the promise, and I encourage you to read the Tampa Tribune series. It is obvious that it is unraveling, that it was pressed on them by insurance companies, and a lot of these big rate increases that we are facing along the coast have to do with collusion and pressure being brought to bear on these modelers to raise the rate and to throw away the science.

Chairman LEAHY. Thank you.

Governor Racicot, I was listening to your testimony, and you were talking about the things that are allowed under McCarran-Ferguson, that the Congress has allowed by passing that bill. But, of course, unsaid in that is that if we repeal the law, then you have a whole different field in which you have to act.

You acknowledge in your testimony that certain collective activities by insurers would result in antitrust verdicts against the insurers. But the antitrust laws, of course, were developed to permit collective activities that benefit consumers and prohibit those things that harm consumers.

Mr. Hunter has talked about certain collective practices by insurers that harm consumers, including actions setting rates that yield high prices, inclusive actions on claims practices that would reduce payouts.

Are these the activities that you say would violate the antitrust laws?

Mr. RACICOT. I would say anything that focuses upon price setting or collusion of any kind whatsoever would be clearly against the law and ought to be vigorously prosecuted. What I am suggesting—

Chairman LEAHY. And would not be shielded by McCarran-Ferguson?

Mr. RACICOT. There are State laws in virtually every single one of the States that we are talking about this morning, State antitrust laws, and clearly anything that is not regulated by the State is scrutinized in a searing fashion is subject to Federal application of the antitrust laws. And, Senator Leahy, if I could add, the testimony we have heard this morning fills, I think, every one of us with extraordinary sorrow and regret, and it is very moving, and these are very serious problems. But the repeal of McCarran-Ferguson really does not have much to do with these issues at all, because, quite frankly, it has to do with whether or not in the light of day you are going to allow for the activity of insurance companies to actually bring a better bargain to consumers. There is a good reason to take a look at data collection. There is a good reason to compare loss figures. There is a good reason to establish residual markets. And you cannot do that without information.

But if you have the specter of antitrust Federal law enforcement staring you in the face because you simply will not proceed with the kind of disclosure that would allow for that kind of information to be distilled and used in driving a better bargain for consumers. That is what Congress recognized in 1945.

Chairman LEAHY. Well, my time is up, and as has been testified, in 1945, I think as Senator Lott pointed out, there were—you could go back in the history and have a different view of it. It is the law today. Neither of us debate that. Our debate is going to be whether we want the law to continue.

Senator Hatch?

Senator HATCH. Well, thank you, Mr. Chairman.

Governor Racicot, in your written testimony, you argue that the McCarran-Ferguson Act is based on the key principle that where there is an effective regulatory system in place, it should not be duplicated through application of the Federal antitrust laws.

Now, I do not disagree with you that Congress has at times passed laws reflecting the view that active regulation was sufficient to deter harmful behavior, making antitrust enforcement duplicative and, of course, unnecessarily burdensome. But I do have some questions about the rationale for applying those arguments in the context of the insurance industry.

First, it seems to me that this dichotomy between regulation and antitrust enforcement arises primarily with respect to regulated monopolies and industries subject to common carrier regulation. In general, this type of regulation included things such as the strong rate regulation to limit the extraction of monopoly profits from consumers, obligations to offer service to everyone within a specified service area, and prohibitions on discontinuing service without obtaining regulatory approval.

Now, the question I am going to ask is this: To what extent do the States currently have this type of regulation for insurance providers? And, of course, after you respond, I would like to hear from Commissioner Voss and then Mr. Hunter as well, if we could.

Mr. RACICOT. Well, Senator Hatch, I would argue that there is no industry in America, no financial services industry in America that is more heavily regulated than the insurance industry at the State level, and sometimes in our mind some overregulated. Insurance Commissioners most certainly have the capacity to do anything and the regulatory process is to ensure that a company does not to go into insolvency because it simply cannot meet its financial obligations.

So the bottom line is there is a very pervasive, universal system of regulation and control across the United States of America. Every State in the Union has either antitrust provisions or deceptive practices provisions in place, and they are vigorously enforced. And as a consequence of that, I think what Congress recognized in 1945 was this: that it was better in the light of day to advance discussions out into the marketplace that allowed for data to be used in a common fashion so as to bring a better price and a better product to the consumers of this country. They provided for the exemption to allow for those things without antitrust enforcement impinging upon the industry's ability to do that.

We believe the same thing Senator Leahy talked about in his opening comments, and that is, driving a bargain in the light of day is in the best interest of the consumers of this country, the more competition, the better. That is why you will see the testimony from the National Association of Insurance Commissioners reflects that there are in excess of 5,000 insurance companies in this country, property/casualty companies, that provide coverage. I do not think you will find one of them that believes that proceeding in this fashion is a good idea for consumers or for States. And the reason for that is they know that business is being conducted in the light of day and that this is in the best interest of consumers.

Senator HATCH. Well, thank you.

Commissioner Voss?

Ms. VOSS. Thank you, Senator. I would add that while I think that I like to believe that State regulators do an excellent job—and we do care about consumers. In Iowa, we have the lowest auto rates in the country, some of the lowest worker comp rates. So we know that there is good competition. But I would admit that there are some bad actors out there. There are some issues that we would enjoy the cooperation of the Federal Government. If you go back and look at the Marsh issue and at that time Attorney General Spitzer—I mean, we recognize there are times where we could work together effectively on certain issues, and we would welcome that relationship very much.

Having said that, we do know that—I believe we do an excellent job at rate review and consumer protection when there are unfair claim practices. And so we are concerned that we would open the door too much. But as I have said before, I think we welcome the ability to work with you when we believe there are issues of bad faith and perhaps criminal activity in our own industry. And we do know that occurs.

Senator HATCH. Well, thank you.

Mr. Hunter?

Mr. HUNTER. State regulation is very weak. Half of the regulatory money and people are in four States. Those four States come close to perhaps meeting your standard. I would say no State meets the State action doctrine standard that would apply if—and, therefore, if they really wanted to oust antitrust—if you repealed this, they would have to upgrade.

The problem is the courts oust the antitrust enforcement of the Federal Government on just the law on the books, no matter how weak or not even enforced. And you can look at the record on that. And so you have a lot of States with virtually no capacity to regulate.

Senator HATCH. My time is up, Mr. Chairman.

Chairman LEAHY. I know all of you have traveled a long way to be here. Because of the joint meeting, I am going to leave the record open so people can submit questions. Also, if there is no objection, I am going to leave the record open so that both Senator Lott and Senator Landrieu can submit questions. I know that Senator Landrieu has talked to me about Mr. Homan's situation and has questions, and Senator Lott has, and without objection, we will leave the record open.

I thank all of you for coming. Those who testify here on a regular basis know that sometimes these things get truncated, but it is appreciated and it is important.

Mr. Homan, thank you for making the trip here. Commissioner Voss, make sure that the Senators from Iowa treat you well while you are here in town. Take care.

[Whereupon, at 10:30 a.m., the Committee was adjourned.]

[Questions and answers and submissions for the record follow.]

QUESTIONS AND ANSWERS

CFA **Consumer Federation of America**

March 27, 2007

Sen. Patrick Leahy, Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510-6275

Re; McCarran-Ferguson Antitrust Exemption
Hearing of March 7, 2007 – Questions from Sen. Specter

Dear Mr. Chairman:

Let me first thank you, Mr. Chairman, for the honor you gave me by inviting me to testify at this very important hearing.

Following are the responses to the questions posed to me by Ranking Member Specter in your letter dated March 15, 2007:

QUESTIONS

1. In your written testimony, you indicate that you believe the collection and dissemination of historical claims statistics would not violate the antitrust laws, but that manipulation of such statistics to project future losses and the distribution of such projections would violate the antitrust laws.

    a. Can you explain why you draw the line between legal and illegal conduct there? Does the fact that a third party develops the projections affect your analysis at all?
    b. How would you respond to those who argue that small insurance companies need the projections like those provided by ISO in order to stay in business?
    c. When McCarran-Ferguson was enacted, do you believe Congress intended to insulate conduct such as the joint development of claims projections?

2. In your written testimony, you suggest that advisory organizations such as the Insurance Services Office, modeling agencies and other third parties have facilitated collusion in the insurance industry. I find that deeply concerning, but I know some in the insurance industry have stated they believe information sharing is necessary for the industry to make accurate claims projections and therefore benefit consumers.

a. How would you respond to claims by industry that information sharing benefits consumers?

ANSWERS

Response to Question 1a:

Legal scholars have said for decades, particularly during hearings held by Chairman Jack Brooks of the House Judiciary Committee in the early 1990s, that the provision of joint historic data would not violate federal antitrust laws. What these legal experts saw as not passing legal muster was manipulating the historic data by making future projections as to rates or premiums. From my perspective in regulating and closely analyzing the insurance market for over 40 years, this distinction makes practical sense. The use of such joint historic information will help insurers to more accurately assess risk, enter new markets and offer consumers fair rates. However, manipulating and standardizing the process of projecting future losses and rates based on historic data is plain, old-fashioned collusion.

Smaller insurers, and even larger companies looking to enter new lines of insurance or new states, need historic data to effectively evaluate risk and make these competitive moves. But they do not need to agree on what will happen in the future. Once the data are available, there are plenty of independent consulting actuaries to make the projections. According to the 2007 Yearbook of the Casualty Actuarial Society, there are only 139 actuaries serving in the rating organizations and 895 actuaries acting as consultants.[1]

Decisions on what inflation will be, what events impact coverage, how much loss adjustment expenses will cost and other such determinations for the future are the stuff of competition which are snuffed out by joint pricing decisions today made routinely by ISO and other advisory and rating organizations.

The use of third parties (such as independent consulting actuaries) is not anti-competitive per se. However, when third parties serve as a vehicle for joint decision-making and rate making, their role is certainly anticompetitive. For instance, consider the role played by ISO and similar organizations in setting future projections high enough to assure that the least efficient member of the insurance cartel that ISO and other such organizations serve flourishes.

Response to Question 1b:

Small insurance companies (and large insurance companies) need to project their pricing into the future, just as providers of other services and products must do. But they do not need to do it jointly, just as other participants in the American economic system need not do so. If a small insurer cannot afford a consulting actuary for this service, I would argue that it is too small to be allowed to write insurance. Actuarial services are not

[1] Statistics shown on page 59 of the Yearbook.

prohibitively expensive. Small companies must hire actuaries for certain activities in any event (such as signing annual reports and other documents and setting reserves), and that has not stopped them from being viable.

Response to Question 1c:

It is clear that, when enacting McCarran-Ferguson, Congress intended that the antitrust laws fully apply to insurance after a short, two-year, moratorium. There was no intent to create a permanent exemption by either Congress or the Executive, as a review of the legislative history makes crystal clear.[2]

Response to Question 2a:

Collusive activity to underpay claims or to raise RMS hurricane model prices can never be favorable to consumers. Joining together to develop useful historic data is a good thing for consumers. Projecting these data into the future jointly, in a way that assures success for the least efficient member of the joint group, is unfavorable for consumers. Price fixing, even only for part of the rate (the largest part, the claims) is not helpful for consumers, ever.

If information sharing among erstwhile competitors is so good, why is the law of the land for almost every industry except insurance to the contrary?

It is high time that the insurance industry becomes a member of the competitive American economic system!

Yours truly:

J. Robert Hunter
Director of Insurance

[2] I encourage you to review the 1994 Committee report of the House Judiciary Committee on this issue.

American Insurance Association

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March 29, 2007

The Honorable Patrick Leahy
Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Chairman Leahy:

Thank you for inviting me to testify at your Committee's hearing regarding "The McCarran-Ferguson Act and Antitrust Immunity: Good for Consumers?" on March 7, 2007.

Enclosed are the responses to the written questions from Committee members. An electronic version of these responses has also been sent to Nikole Burroughs at Nikole_Burroughts@judiciary-dem.senate.gov.

Again, thank you for allowing me to participate in the hearing. If you have any questions, please contact Margaret Simmons of my staff at (202) 828-7173.

Sincerely,

Marc Racicot

Marc Racicot
President

UNITED STATE SENATE
COMMITTEE ON THE JUDICIARY
"THE MCCARRAN-FERGUSON ACT AND ANTITRUST IMMUNITY: GOOD FOR CONSUMERS?"
MARCH 29, 2007

RESPONSES OF THE
AMERICAN INSURANCE ASSOCIATION TO QUESTIONS POSED BY CHAIRMAN LEAHY, RANKING MEMBER SPECTER, AND SENATOR LANDRIEU

Question from Chairman Leahy

1. At the hearing, I asked about a statement in your prepared testimony in which you acknowledge that certain collective activities by insurers would result in antitrust verdicts against insurers, were the federal antitrust laws to apply to the business of insurance. You responded that "anything that focuses upon price setting or collusion of any kind whatsoever would be clearly against the law and ought to be vigorously prosecuted." Does AIA therefore support statutory repeal of the antitrust immunity to prohibit "any activity that focuses upon price setting, or collusion of any kind" within the business of insurance?

There is a two-part answer to your question. First, AIA does not support statutory repeal of the limited antitrust protection provided by the McCarran-Ferguson Act (McCarran) because that will destroy the balance between state regulation and federal antitrust enforcement established by McCarran without addressing the pervasive and overly intrusive nature of state insurance regulation. The result will be a multi-layered regulatory and enforcement structure consisting of state regulation (including existing rate and policy form regulation), state antitrust enforcement (to the degree that the state is not engaging in regulation), federal enforcement of the federal antitrust laws subject to the "state action" doctrine, and private enforcement of those same federal laws through the courts.

It is important to remember that McCarran is a power-sharing statute that delegates authority to regulate insurance to the states, while creating an antitrust regime that respects the regulatory authority delegated to the states. By merely repealing McCarran's limited antitrust exemption, without addressing the ongoing delegation of regulatory authority to the states, Congress would expose the industry to a complex web of both state and federal enforcement and a different antitrust dynamic, which could cause the states or insurers operating in those states to seek even more regulation added onto an already burdensome patchwork quilt of state and federal oversight. Ironically, such a result would run counter to the purpose of the antitrust laws, which is to encourage, not stifle, competition in a free market environment.

Second, your question presents an opportunity to reiterate AIA's position on the application of federal antitrust laws to the business of insurance. Given the purpose of the federal antitrust laws – to enforce competition to the benefit of consumers in a free market environment – it would be wholly appropriate to apply those laws to competitors operating in such an environment. Unfortunately, the business of insurance, while involving thousands of competing insurers, does not take place in such an environment. As noted in the AIA written statement, every state regulates property-casualty insurance rates or policy forms, and often both, through the use of government price and product controls. Thus, the states have chosen to exercise government economic regulation where, for other industries, free markets determine the range of prices and products available to consumers. In this case, because of the extensive nature of government economic regulation over the business of insurance, it is wholly inappropriate for additional enforcement to occur through application of the federal antitrust laws. From AIA's perspective, were the regulatory environment to shift from one of economic regulation through government price and product controls to a free market orientation, then the dynamic would shift to federal antitrust enforcement. Absent that shift, removal of the McCarran antitrust protection will simply introduce an additional layer of regulation into an already pervasive state regulatory system, diminishing the opportunities for free markets to flourish to the benefit of consumers. This would not be a result that is consistent with good regulatory or antitrust policy.

2. In your prepared testimony, you state that the determination of how to draw the balance between regulation and antitrust policy "does not differ from industry to industry." The balance struck by the Supreme Court for virtually every other regulated industry is that the antitrust laws apply unless the challenged conduct was engaged in pursuant to a clearly articulated State policy actively supervised by the State. If, as you testified, the balance should be the same in each industry, should that standard not also apply to the business of insurance?

There seems to be a misconception that the only applicable standard is the state action doctrine. As discussed in the AIA written statement, that is not the case. For purposes of federal antitrust enforcement, insurance should be compared to the other two legs of the financial services sector – banking and securities – which are principally regulated at the federal level. Those federally-regulated industries are governed by the exclusive jurisdiction doctrine, not the state action doctrine. See, e.g., Gordon v. New York Stock Exchange Inc., 422 U.S. 659 (1975); United States v. National Ass'n of Securities Dealers, Inc., 422 U.S. 694 (1975). This doctrine provides that federal antitrust lawsuits cannot be used to undercut the federal regulatory system established by Congress, and activities undertaken within that regulatory system. In the same way, the standard established by McCarran's balance of regulation and antitrust makes certain that the decisions made by state regulators and legislators on behalf of the public are not subject to collateral attack under the federal antitrust laws.[1] Were Congress to decide to reclaim

[1] It is noteworthy that a number of states have codified a regulated industries exemption that functions similarly to prevent state antitrust laws from interfering with state regulatory systems, and that states that do not protect regulated industries by statute do so through case law. Insurance Antitrust Handbook, American Bar Association, Section on Antitrust Law, at 39 (2nd ed. 2007).

regulatory authority over the business of insurance from the states through specific federal legislation, that doctrine would almost certainly apply in the courts.

In contrast, the state action doctrine is very different in its application, and much more oriented toward litigation than towards a stable legal environment that respects state legislative and regulatory decisions. Thus, for the state action doctrine to apply, the courts must decide in each case whether (1) the legislation had sufficiently articulated the state's policy to displace competition and (2) whether the state had actively supervised the conduct authorized by state law.

Therefore, it is not analytically appropriate to equate the exclusive jurisdiction doctrine, which is applicable to the other two federally-regulated participants in the financial services sector, with the state action doctrine. In this connection, the exclusive jurisdiction doctrine is much more respectful of both Congressional policies and the methods chosen by federal regulators to enforce those policies than is the state action doctrine with regard to state legislation and enforcement.

As noted above, ironically, a repeal of McCarran's limited antitrust exemption (which currently serves as the insurance industry's equivalent to the exclusive jurisdiction doctrine) and the resulting reliance on the state action doctrine to establish the relationship between state regulation and federal antitrust enforcement, will likely lead to even greater and more draconian state regulation, further stifling innovation and competition.

Questions from Ranking Member Specter

1. ***In your prepared testimony, you discuss the impetus for Congress's adoption of McCarran-Ferguson in 1945. Can you point to any evidence that Congress intended McCarran-Ferguson to permit the type of extensive information sharing that occurs in the insurance industry today?***

One of the leading U.S. Supreme Court decisions on the McCarran antitrust provisions points to legislative history to support the proposition that one of McCarran's primary purposes was to allow the insurance industry to share information pursuant to state regulation. See, Group Life & Health Ins. Co., et al. v. Royal Drug Co., Inc., et al., 440 U.S. 205, 221-222 (1979) ("'To prohibit combined efforts for statistical and rate-making purposes would be a backward step in the development of a progressive business. We do not regard it as necessary to labor this point any further because Congress itself recently recognized the necessity for concert of action in the collection of statistical data and rate making when it enacted the District of Columbia Fire Insurance Rating Act.'" (quoting 90 Cong. Rec. A4405 (emphasis added))

2. ***In your prepared testimony, you suggest that states have placed all collective activity by insurers under "regulatory control, scrutiny and review." What about cases like Marsh & McLennan, where there was blatant bid rigging? Are you saying that***

[the] state regulatory system was effective in overseeing the collective activity involved in that case?

The bid-rigging actions were initiated entirely by state regulatory authorities, involving cooperation among state insurance regulators and attorneys general in multiple states. These regulators perceived a problem, investigated that problem, and prosecuted that problem pursuant to their state authority. As set forth in AIA's written statement, "the joint investigations into, and the private litigation over, broker compensation practices are a recent reminder of the ability and willingness of state insurance departments, attorneys general, and private litigants to pursue conduct that they believe violates the law."

3. ***In your testimony, you suggest that the balance between antitrust and regulation "does not differ from industry to industry." But, isn't it true that the insurance industry gets special protection from the antitrust laws, even where there is little applicable state law or state law is not enforced?***

a. In your testimony, you suggest application of the antitrust laws would duplicate an effective regulatory system. As you know, the state action doctrine stays the application of antitrust laws where there is active state regulation. Given the state action doctrine, why would repeal of the McCarran-Ferguson Act result in duplication of the regulatory system?

b. You suggest the state action doctrine would destroy the balance between state insurance regulation and antitrust laws. Doesn't the state action doctrine strike the balance between regulations and antitrust laws that virtually every other industry in America deals with?

Chairman Leahy has asked similar questions concerning the interplay between the McCarran antitrust provision and the state action doctrine, and the protections that are available to other industries. In this regard, we refer you to AIA's responses to those questions, at pages 1-3. In addition, in response to part (b) of your question, we do not believe that the state action doctrine strikes the appropriate balance between regulation and antitrust enforcement for the insurance industry, nor do we believe that application of that doctrine under the current regulatory construct places insurance on the same level playing field as other financial services sector industries. To the contrary, these other industries enjoy protection from federal antitrust litigation pursuant to general federal antitrust laws under the regulatory systems that Congress has enacted for those industries. Were the state action doctrine to replace the McCarran antitrust standard for the business of insurance, there would be no presumption of deference accorded to the insurance regulatory system established by the various state legislatures.

4. In some states, if collective activity by insurers is subject to state antitrust enforcement, why would such activity not be subject to federal antitrust enforcement?

As noted immediately above, if "federal antitrust enforcement" means application of the state action doctrine to insurance activities regulated under state law, then this enforcement will serve no purpose other than to undercut the prerogative of the state legislatures in establishing their respective insurance regulatory systems pursuant to McCarran's delegation.

5. Can you elaborate on why insurance companies should be able to share cost data, and how consumers benefit from such practices?

The U.S. Supreme Court has long held that the federal antitrust laws permit industry competitors to share cost data. See Maple Flooring Mfrs. Assn. v. United States, 268 U.S. 563, 583-584 (1925) ("It was not the purpose or the intent of the Sherman Anti-Trust Law to inhibit the intelligent conduct of business operations ... enlightened by accurate information as to the essential elements of the economics of a trade or business, however gathered or disseminated. Persons who unite in gathering and disseminating information . . . and who report market prices, are not engaged in unlawful conspiracies in restraint of trade . . . for the simple reason that the Sherman Law neither repeals economic laws nor prohibits the gathering and dissemination of information.") (emphasis added). See also Sugar Institute, Inc. v. United States, 297 U.S. 553, 598 (1936); United States v. Citizens & Southern National Bank, 422 U.S. 86, 113 (1975); United States v. United States Gypsum Co., 438 U.S. 422, 441 n.16 (1978). The Maple Flooring Court went on to explain the consumer benefits that flow from the sharing and availability of cost data:

> "It is the consensus of opinion of economists and of many of the most important agencies of Government that the public interest is served by the gathering and dissemination, in the widest possible manner, of information with respect to the production and distribution, cost and prices in actual sales, of market commodities, because the making available of such information tends to stabilize trade and industry, to produce fairer price levels and to avoid the waste which inevitably attends the unintelligent conduct of economic enterprise. . . . Competition does not become less free merely because the conduct of commercial operations becomes more intelligent through the free distribution of knowledge of all the essential factors entering into the commercial transaction."

268 U.S. at 582-583 (emphasis added). Insurance consumers should not be denied the benefits that would accrue from the sharing of such data. Indeed, we would suggest that those benefits would be enhanced if the state regulatory system abandoned its preoccupation with government price and product controls, and instead allowed competition to flourish in a free market environment.

Questions from Senator Landrieu

The McCarran-Ferguson Act allows insurance companies to engage in a number of collective activities that may violate federal anti-trust laws, but for the exemption. One of these activities is the sharing of loss data. The information is collected by private "advisory organizations" – to use your description – that analyze

the data. It is my understanding that these advisory organizations also calculate loss trends. This analysis is used by insurance companies to set premium rates. I have a number of questions about these advisory organizations and the role they play in the insurance marketplace.

1. Please provide a list of the major advisory organizations for the property and casualty insurance industry. What is the ownership structure of these organizations? Do insurance companies have an ownership stake in these organizations? Do insurance company representatives sit on their boards of directors?

2. How do these advisory organizations develop the models they use for loss trend analysis? Do state government insurance regulators have any oversight over these associations or approval authority over these models? How often are these analytical models modified? Are such modifications subject to state government approval? Were these models altered after Hurricane Katrina?

3. Do state regulators have the expertise to properly assess these models or to create their own models? Is there a federal role for giving states guidance on reviewing these trending models or creating their own? What would your association's position be on a state and/or federal government involvement in assessing trending models?

McCarran only allows the insurance industry to engage in collective activity involving the business of insurance to the extent that business is regulated by state law. With regard to loss data, you are correct that this information is collected by organizations established to perform that function. You describe them as "private" organizations, but these organizations are licensed by state law and regulated by state insurance departments. Thus, while they are private entities, they are state regulated. Your understanding is also correct that these organizations develop loss trends using that collective data. It is important to understand that these advisory loss costs are filed with and reviewed by state regulators.

You have posed a series of questions concerning the nature, structure, and activities of advisory organizations. The largest insurance advisory organization is the Insurance Services Office, Inc. (ISO), located at 545 Washington Blvd., Jersey City, NJ 07310-1686 (Telephone: 1-800-888-4476). As AIA is not an advisory organization and is not in a position to answer those questions, we respectfully suggest that you contact ISO directly.

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NAIC Responses to Member Questions

"The McCarran-Ferguson Act and Antitrust Immunity: Good for Consumers?"

Senate Judiciary Committee Hearing
March 7, 2007

Susan Voss, Commissioner

Iowa Insurance Division, State of Iowa

For the National Association of Insurance Commissioners (NAIC)

April 5, 2007

RESPONSE TO CHAIRMAN LEAHY (D-VT)

1. *You emphasized federal-state prosecutorial cooperation in your testimony. You specifically stated that, "[a] ny federal legislation should include provisions that authorize federal-state collaboration to identify, investigate, and prosecute bad actors in the business of insurance who engage in anti-competitive practices." Please elaborate on any and all anti-competitive practices that insurers may currently be engaging in, free of the Department of Justice's oversight.*

The Act does not bar federal investigation of anti-competitive practices. The Act expressly states that federal antitrust law applies to the business of insurance except where the states regulate the practice. 15 U.S.C. §1012(b). The Act does not limit federal investigatory authority of anti-competitive practices; rather, the threshold barrier to federal prosecution is whether a state regulates the identified practice.

The opportunity for federal-state collaboration exists whether a state regulates the practice or not. Where the Department of Justice investigates conduct in the insurance industry and finds anticompetitive behavior, it can inform a state insurance regulator about alleged anticompetitive practices and invite the state to pursue investigation and prosecution under state antitrust or unfair trade practice law. In most situations, however, the limited federal antitrust exception would not apply because the state does not regulate the identified practice, which frees the federal government to prosecute under federal antitrust laws. In its recently-released final report, the federal Antitrust Modernization Commission (AMC) encourages state and federal antitrust enforcers to coordinate activities and to harmonize their substantive enforcement standards. *AMC Report and Recommendations,* at v. (April 2007).

States are vigilant in their efforts to identify and stop anti-competitive practices, but no level of government is omniscient about events before they occur. Through the NAIC, state insurance regulators are making progress together to identify, isolate, investigate, and eradicate anti-competitive practices in the business of insurance. For instance, in the area of market conduct, the NAIC's Market Analysis Working Group (MAWG) adopted protocols for the coordination and collaboration of market regulatory interventions. MAWG assists states through a peer-review process to identify market activities that have a national impact, offering guidance to states on initiating appropriate regulatory action against insurance companies and producers, and encouraging the examination of key market issues. The states, however, could benefit from additional investigative tools to protect consumers. While states are currently able to obtain access to the FBI database through the adoption of proper legislative authority, federal law prohibits states from sharing criminal history record information with each other. The NAIC continues to seek solutions to enhance states access to the FBI database and resolve the prohibition against the sharing of such information among the states.

RESPONSES TO SEN. SPECTER (R-PA)

1. *You have stated that repeal of McCarran-Ferguson would put a stop to insurance industry practices that benefit consumers and promote competition. As examples of pro-competitive practices, you cite information sharing through ratings and statistical organizations. However, Mr. Hunter argues that such information sharing in many cases reduces competition and raises prices that consumers pay. Do you have any evidence that he's wrong?*

    a. *Mr. Hunter contends that insurance companies use ratings and statistical organizations to signal the market when they want to raise rates or abandon a market. How do you respond to that?*

Economists have long argued that an efficient and effective market for insurance depends upon the sharing of information. Availability of information does exactly the opposite of Mr. Hunter's contention: information increases competition and lowers prices. The more information available such as losses and claims costs, the less able insurers are to price discriminate based on those costs. Limited availability of critical factual information would invite a monopolistic market and function as a barrier to consumer-centered competition.

In Illinois, for instance, workers' compensation insurance reflects the value of information-sharing organizations. Ratings and statistical organizations are subject to state regulation. The shared information is critical because the price of insurance is prospective, not retrospective or static.

Information regarding a trend aids smaller companies – the vast majority of insurance companies – with less-sophisticated databases or fewer professional staff when that smaller company seeks to compete on price and service or gain an increased market share. Also, this benefits consumers by allowing more accurately priced products. Responsible raising or lowering of rates is a reflection of the collective loss data and legislative reforms in a market that the rating organization develops. Loss data is aggregated to provide the rating organization with a "loss cost" or "expected loss potential" that is then provided to insurance companies. The company has to take into account their own experience for expenses and profit loading to develop the rate that the company will use.

Rate markup beyond rating organization loss cost estimates is a corporate decision. Rating organizations are not involved. It is the actual loss costs, not the entity developing them, that insurers use to make decisions about when and where to write business.

2. *In your testimony, you contend that the use of uniform policy forms or policy language is pro-competitive. However, Mr. Hunter argues that using uniform forms and language permits insurers to collude on terms they will offer to consumers. For example, almost every insurer in Louisiana and Mississippi used identical anti-concurrent causation clauses to deny claims where both wind and*

flooding caused damage to a home. Can you explain how the use of uniform forms and language could be pro-competitive?

The goal of uniform forms and language is to provide a level playing field for consumers so they know what specifically they are buying and can compare one product with another. The primary mission of the state regulator is to protect the consumer and ensure that industry participants follow applicable law and regulation. Uniform forms and language are pro-competitive in that they standardize the products offered to the consumer. For example, an "anti-concurrent causation" clause in an insurance policy excludes certain losses from coverage regardless of whether some other cause or event contributes concurrently or in any sequence to the loss. Regulators approve the language of the clause. Insurers using the anti-concurrent causation clause can price their products according to the level of risk assumed under the uniform clause. Alternatively, in the absence of uniformity, the price variation in the products would be significant, and the benefits and coverage less transparent. Moreover, it would impose even more responsibility on consumers to understand the policy terms before the need to file a claim arises.

3. *Mr. Hunter argues that insurers are using new third parties, including modeling consultants that are beyond the reach of state regulators to exchange information used to make pricing decisions. Do you believe that insurers are using these new entities to avoid scrutiny by your state regulators?*

I see no evidence that insurers use third parties such as modeling consultants to avoid scrutiny by our state's regulators.

Insurers are not driven to fail. To understand the risks of a line of business in a geographic or demographic area, insurers must first know the projected costs of the risk. Failure to consider this information would be irresponsible and reckless because if rates are too low, then consumers suffer because the insurer either cannot renew after a serious event or, worse, becomes insolvent and unable to pay claims in a timely or professional manner. Conversely, if rates are too high, then consumers suffer because price eliminates choice. It is not surprising that insurers in the same line of business and in the same geographic or demographic region would consider the same factual information. For example, in the Gulf, insurers must consider weather patterns and data offered by modelers. Whether climate change or global warming, the information allows for responsible rate settings.

Iowa law directs the regulators to require evidence from insurers that property and casualty rates are not excessive, inadequate, or unfairly discriminatory. The regulator may require information pertaining to a rating model, if that is necessary to the regulator's analysis, no matter the source of the model. We do not have the major catastrophe exposures that some states have. However, in a slightly different context, some companies use third party vendors for developing credit scores or "insurance scores." The Iowa division has required insurance companies to share under confidentiality the credit and insurance scoring models.

RESPONSES TO SEN. GRASSLEY (R-IA)

1. *What specific business of insurance practices could be at risk of challenge as violations of federal antitrust law absent the McCarran-Ferguson exemption? Which of these at risk business practices currently benefit consumers or create a competitive market? Can you provide some of examples? Which of these hurt or potentially hurt consumers?*

Practices that face exposure to federal antitrust law absent state law and the McCarran-Ferguson's limited antitrust exemption include:

- policy form standardization;
- joint underwriting and residual market underwriting (i.e. high-risk pools);
- sharing loss cost data;

- statistical activities conducted by rating and advisory organization; and,
- operation of state insolvency funds.

Each of these practices benefits consumers and helps foster a competitive market for insurance. Standardized insurance forms and definitions of risk, for instance, can ease comparison shopping for consumers. Also, use of standardized forms allows for improved data sharing pools for calculating loss costs. This sharing of data can help improve product pricing efficiencies. Joint underwriting provides a method for insurers to share risk that no insurer would assume alone such as high-value or high-risk properties. A lead insurer in cooperation with other insurers spread the risk by each insuring a portion. The limited federal antitrust exemption guards these collaborative efforts from charges of anticompetitive behavior. Repealing the limited antitrust exemption would squeeze those collaborations and limit the insurance options available to owners of high-value or high-risk properties. It would likely chill the ability of any single insurer to write a policy that assumes total risk and to secure reinsurance as a backstop at a reasonable rate. Finally, rating and advisory organizations collect and disseminate statistical information, compile aggregated loss cost data helpful in trending analyses, and provide other services that allow small and medium-sized insurers to compete, thereby improving pricing and choices for consumers. Without applicable state law and regulation, the operation of rating and advisory organizations would be subject to federal scrutiny for potential price fixing as either a per se antitrust violation or an unreasonable restraint of trade.

2. *How do entities like National Council on Compensation Insurance (NCCI) and the Insurance Services Organization (ISO) help or hurt a competitive market? Do these entities help or hinder regulators' understanding of what is going on in the insurance market? Do these entities hinder competition or aid anti-competitive practices? Do these entities act as barriers to entry in the insurance markets, or not?*

Entities such as NCCI, ISO and American Association of Insurance Services (AAIS) help improve competition and regulator's knowledge of the industry.

In most states, data is collected and interpreted by rating organizations and transmitted to insurers as aggregated loss cost data, which indicates expected loss potential. Insurers independently determine prices for their products after considering past experiences, market competitiveness, and the aggregated loss cost data. Rate markup beyond rating organization loss cost estimates is a corporate decision. Rating organizations are not involved. Restrictions on sharing information necessary to formulate rates would impair competition by affording larger insurers a competitive advantage over small and medium-sized insurers, reducing over time the number of insurers in the market and providing consumers with far fewer choices.

Competitive markets rely on availability of information. Without rating organizations, small and medium-sized insurers would face a barrier to entry because the lack of available loss cost information available to them would restrict their knowledge about risks they would insure. Forcing small insurers to abandon rating organization services would force them to compete against larger firms with the capacity to generate independent, actuarially-reliable data. This would only serve to further consolidate the insurance industry and reduce competition in the market. Furthermore, the elimination of a common data source that rating organizations provide would segment the data among individual companies and invite price discrimination based on loss costs.

As long as rating organizations are open and accessible to state regulators, they will be useful in identifying and determining when market challenges occur and why. For example, one of the most troubled insurance markets over time has been medical malpractice insurance. Part of the challenge for regulators is the lack of a ratings organization to standardize malpractice claims and loss data because many insurers choose not to participate in the agencies. This prevents regulators from relying upon a uniform, standard source when analyzing and evaluating the medical malpractice market. For this reason, state regulators would support a modification to pending congressional legislation to reform the surplus lines, or "excess carrier" market, to require a medical malpractice carrier to report to its state of domicile its loss and claims data for each health care specialty.

3. *Would a total repeal of the McCarran-Ferguson antitrust provision affect all companies and markets the same way? Please elaborate.*

The business of insurance is competitive under the state regulatory system. While more companies have been formed in each of the last three decades – and while the number increases – the number of insurers subject to regulatory supervision or receivership proceedings due to financial status is a mere two-thirds of one percent. With the combined boundaries of state regulation and the McCarran-Ferguson limited antitrust exemption, the insurance industry has a competitive structure given the number of competitors and the ease of entry. Although a particular type of coverage may have limited sellers at a given point in time, the number of potential sellers is in the thousands. Additionally, access to the market is relatively simple, as minimal but sufficient capital and licensing are the basic requisites for entry.

Repeal of the limited federal antitrust exemption would not result in the intended benefits but would cause the opposite: diminished competition by reduction of the number and quality of insurers, principally small and medium-sized insurers.

4. *What impact would a repeal of the antitrust exemption have on state efforts towards modernization and uniformity in the regulation of insurance?*

Repeal of McCarran would chill ongoing state modernization efforts because uncertainty and the constant threat of litigation would cloud whether the states or federal government regulate the insurance industry.

Full application of federal antitrust laws may be appropriate for industries in which the business is free from excessive governmental regulation and a product or service is transferred or provided at the time of payment. For reasons that seem counter-intuitive, the insurance industry does not fit this paradigm. First, because state regulators must ensure insurer solvency, the unfettered acceptance of risk is not permissible for insurance carriers. State regulators focus on the financial soundness and solvency of companies to protect consumers who, in consideration for premiums paid, rely on insurers to pay claims when filed. Insurance involves the payment of a premium today in return for a promise to pay in the future upon the occurrence of certain contingencies which cannot always be precisely projected.

Second, state regulation necessary with respect to pricing, forms, coverage, financial condition and other critical matters, and the need to provide or facilitate the operation of market mechanisms to offer essential coverage, substantially differentiates the insurance industry from other businesses. Assumptions appropriate in other contexts where federal antitrust laws apply in full -- contexts in which the free market permits the business to open and then fail with the impact falling primarily upon owners or shareholders -- do not apply to the regulated insurance market.

The limited federal antitrust exemption for the business of insurance, combined with effective state regulation, has generated competition that has flourished and served the consumer interest. Repeal would not appear to improve insurance affordability or availability but, instead, would inject uncertainty into an industry where stability and predictability are attracting necessary infusions of capital. Effective regulation will be impossible if inconsistent and unpredictable judicial interpretations and legal doctrines are substituted for past experience.

5. *Is there settled precedent on the State Action doctrine in state and federal courts? If not how might this affect the markets and consumers?*

Settled precedent exists on the standards of the State Action doctrine, but not necessarily on its application to specific antitrust matters associated with the business of insurance. The state action doctrine grants antitrust immunity from the Sherman Act for state regulation. *Parker v. Brown*, 317 U.S. 341, 351 (1943) (The Sherman Act does not "restrain a state or its officers or agents from activities directed by its legislature; however, a state does not give immunity to those who violate" the Act by authorizing them to do so, or by declaring their actions legal). Subsequently, the Supreme Court fashioned a two-prong test to determine when a state was regulating antitrust practices. *California Retail Liquor Dealers Association v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980). State antitrust regulation is immune from the Sherman Act if the state has: (i) clearly articulated and affirmatively expressed" the policy, and (ii) the policy is "actively supervised" by the state. *Midcal*, 445 U.S. at 105. A challenge with applying the state action doctrine is reaching a level of judicial consistency with the "actively supervised" prong. While "active supervision" requires more than a "gauzy cloak of state involvement," (*Midcal* at 106) the inquiry is "not to determine whether the State has met some normative standard...in its regulatory practices." *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621. 634 (1992). The late Chief Justice Rehnquist, dissenting in Ticor Title, implied that the application of the *Midcal* test may not be clear-cut, foreshadowing litigation to clarify its parameters. The Chief Justice argued that the majority rule "necessarily puts the federal court in the position of determining the efficacy of a particular State's regulatory scheme" to determine state compliance with *Midcal*. But, the Court's focus on actions taken by state regulators "necessarily requires a judgment as to whether the State is sufficiently active - surely a normative judgment." *Ticor Title*, 504 U.S. at 645.

Years of litigation in multiple jurisdictions – including within the same state where conflicting decisions could arise – would be necessary to develop uniform precedents among the federal and state circuits. Even assuming that courts apply the State Action doctrine uniformly, the likelihood of litigation remains strong because the facts and circumstances of each case are determinative in antitrust matters. Litigation will create sufficient uncertainty to chill the introduction of new insurance products, limit options for consumers, and negatively impact prices. Litigation will also force states, generally, and state departments of insurance, in particular, to reallocate limited staff and financial resources away from more productive uses.

6. *Describe what the Iowa Insurance Department does presently to identify and remediate alleged anti-competitive insurance industry practices against consumers? How might expanded federal involvement impact the State's current efforts?*

In Iowa, rates, rules, and forms used by insurance companies are reviewed by regulators who can identify possible areas of anti-competitive behavior. As an example, companies are allowed to use others' rates in support of their own. The use of others' rates can further competition, such as when a smaller company uses the expertise of a larger company to set a rate appropriate to the risks in the area. It would be uncompetitive for a company with sufficient experience to price a risk appropriately to use another company's rates in order to obtain higher than necessary rates. The regulator would review the filing and determine whether the use of the other companies' rates is appropriate.

The extent and manner of regulatory scrutiny given to the various products and rates is determined in part by the competitiveness of the market. When a market is functioning, tight scrutiny of the rates and available products is not as necessary. Companies will try to improve their rating structures and offer more desirable products in order to attract more customers. Iowa law provides for different treatment of competitive markets in property casualty rate filing procedures and reviews. The law allows the commissioner to make a determination regarding the competitiveness of markets. It specifies factors to consider in making the determination. One of the ways in which the law provides for less scrutiny for competitive markets is that rate filings must be made within 15 days of using the rates instead of the standard requirement of rates needing to be filed 30 days before their intended use for noncompetitive markets. Both personal auto and homeowners insurance have been determined to be competitive in Iowa.

Regulators in Iowa monitor the marketplace for signs that particular markets may be becoming non-competitive. Industry data and communications with companies, agents, and policyholders offer indicators of competitiveness. Company, agent, and policyholder complaints are researched. Iowa works with other states in monitoring complaints against agents and companies. When the marketplace is becoming less competitive, complaints from agents and policyholders will include more information regarding availability of coverage or high prices. In a more competitive market, complaints will include more concerns from companies and agents about low prices and new product offerings by other companies.

Through public records laws, companies have access to products and rates of competitors and the public has the ability to see what products are available and how rates are developed. This promotes new and innovative products, which gives choices to consumers.

Federal involvement could aid or hinder state regulation depending upon how it is structured. To aid state regulation, federal involvement should be used in conjunction with the regulatory needs of each state, be uniform for all companies within the states but responsive to state differences, and not affect the ability of companies to obtain state approval where needed. Current NAIC activities, such as states' sharing of data and information and working together, help state efforts.

RESPONSES TO SEN. LANDRIEU (D-LA)

1. *Please describe what kinds of practices might constitute an act of boycott?*

The boycott exception incorporated into the limited federal antitrust exemption resulted from conduct alleged against insurers in *United States v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), the case that prompted adoption of the McCarran-Ferguson Act. In that case, it was alleged, among other things, that insurers that were not Association members were denied access to reinsurance, and agents that represented non-Association insurers were denied the right to represent Association members. "Boycott" was interpreted by the Supreme Court in *St. Paul Fire & Marine Insurance Co. v. Barry*, 438 U.S. 531 (1978), to include boycotts of policyholders. In the *St. Paul* case, it was alleged that three insurers had refused to sell insurance to plaintiffs in order to force them to purchase from a fourth insurer. The Supreme Court found that only refusals to deal involving the concerted actions of multiple parties constitute boycotts. In *Hartford Fire Insurance Co. v. California,* 509 U.S. 764 (1993), where the central allegation was that insurers, reinsurers, and brokers agreed to boycott insurers that used nonconforming forms, the Supreme Court found that a "boycott" occurs when a group coerces a party to participate in a transaction on certain terms by refusing to deal with that party on another unrelated transaction. Under the *Hartford Fire* analysis, refusing to do business with a customer or group of customers except on certain or standardized terms would not be a boycott, because the refusal is not tied to securing favorable terms in an unrelated transaction.

2. *Would an act of boycott include the non-renewal of policyholders in a geographical region or area? Please explain your response.*

The conduct described would likely not constitute a boycott, unless the refusal to renew was done by several insurers pursuant to an agreement among them and with the goal of securing favorable terms from the policyholders on an unrelated transaction.

3. *Would an insurance company's decision to not write new business in a geographical region or area constitute a boycott? Please explain your response.*

No. The act of an individual company does not constitute a boycott.

4. *In your experience as Insurance Commissioner have you ever handled a situation involving a boycott under McCarran-Ferguson? Please describe.*

I have not encountered this situation.

SUBMISSIONS FOR THE RECORD

ACLI
Financial Security. For Life.

March 13, 2007

The Honorable Patrick J. Leahy
Chair, Senate Judiciary Committee
224 Dirksen Senate Office Building

The Honorable Arlen Specter
Ranking Member, Senate Judiciary Committee
224 Dirksen Senate Office Building
Washington, DC 20510

Re: S. 618, Life Insurance and the McCarran-Ferguson Act

Dear Senators Leahy and Specter,

This letter is submitted on behalf of the American Council of Life Insurers (ACLI), which is the principal trade association for life insurance companies. The ACLI's 373 members account for 93 percent of the industry's total assets in the United States and 90 percent of annual life insurance premiums and 95 percent of annual annuity considerations in the United States. We ask that this letter be made a part of the record of the March 7, 2007 Senate Judiciary Committee hearing entitled, "The McCarran-Ferguson Act and Antitrust Immunity: Good for Consumers?"

ACLI appreciates the opportunity to comment on S. 618, the "Insurance Industry Competition Act of 2007", and the implications of this legislation for life insurers and its supporting organizations. As a threshold matter, ACLI has long-supported McCarran-Ferguson, and believes it has served the public interest well. Given the current discussions occurring in both Congress and the states concerning regulatory modernization of the insurance industry, we believe Congress should demur from making any specific recommendations with respect to McCarran-Ferguson outside the broader context of insurance regulatory modernization. We also urge the Committee to refrain from repealing the existing limitations on FTC authority to investigate insurance activities.

Why the McCarran-Ferguson Act is important for life insurers

The life insurance industry is extremely competitive.[1] This healthy marketplace has benefited American consumers with the McCarran-Ferguson antitrust exemptions well in place. Also, life insurance has always been fully exposed to state antitrust enforcement pursuant to the many existing state antitrust laws, which typically parallel the federal statutes. There is no evidence that life insurers have engaged in anticompetitive conduct; either with respect to setting premium rates or the evaluation and payment of claims. It is important to bear in mind, however, that McCarran-Ferguson remains the statutory foundation for state regulation of insurance. As that regulation has developed it has been understood that certain ancillary life insurance activities are not subject to federal antitrust laws.[2]

[1] According to industry statistics the average annual premium for a $500,000 term policy purchased by a 40 year-old non-smoker is less than half of what it was in 1994. Bad news, good news: millions need life insurance; its getting cheaper USAToday.com, October 9, 2006, citing a survey of the Insurance Information Institute.
[2] The prevalence of state-authorized rating plans and certain data sharing mechanisms result in McCarran-Ferguson being of greater importance to the property & casualty industry. However, reinsurance and certain other aspects of the insurance business that may have McCarran-Ferguson implications are common to all lines.

Senators Leahy and Specter
March 13, 2007
Page 2

Whether the availability of the McCarran-Ferguson exemption for all insurance purposes is really necessary today or not can be debated. But the bar has accustomed itself to this state of affairs, and any change could result in substantial legal uncertainty and resultant litigation that could take years to resolve itself.

Insurance Regulatory Modernization

As you are aware, the insurance industry is undergoing the most significant debate regarding its regulatory future since the Armstrong Committee Report of 1906,[3] which ushered in the modern state of insurance regulation that has persisted for the past one-hundred years. This healthy debate concerning insurance regulation in Congress took the form of several proposals during the 109th Congress: S. 2509 "The National Insurance Act of 2006" (Johnson (D-SD) and Sununu (R-NH)); and H.R. 6225 "The National Insurance Act of 2006" (Royce (R-CA)). In addition, in 2003 the House Financial Services Committee exposed a draft proposal known as the SMART (State Modernization and Regulatory Transparency) Act for public comment. These proposals would all allow for some form of federal regulation of insurance with obvious implications for the continued role of McCarran-Ferguson. Similar legislation is expected to be introduced during the 110th Congress.

On the state side, the National Association of Insurance Commissioners (NAIC) has made a commitment to unifying state regulatory processes and improving operational efficiencies. The modernization of the state-based system of insurance regulation is supported by ACLI, and is an integral part of the evolving debate over how best to oversee the insurance industry and protect the public it serves. The confluence of these state and federal legislative and regulatory activities provides even more reason to defer consideration of McCarran-Ferguson until these developments have taken shape.

McCarran-Ferguson will be a part of the consideration of the future of insurance regulation

Much of the recent debate over McCarran-Ferguson has focused on its limited antitrust immunity for the business of insurance. But McCarran-Ferguson encompasses more than a limited antitrust immunity. The other equally-important element of McCarran-Ferguson expressly reserves regulation of the business of insurance to the states. Congress recognized that without McCarran-Ferguson, the insurance industry would quickly become subject to an unworkable system of simultaneous state and federal oversight.

McCarran-Ferguson must be considered in this broader context. While concerns over McCarran-Ferguson may focus on its antitrust provisions, repealing it would necessarily affect its state regulatory provisions. Repealing McCarran-Ferguson in isolation, without regard to regulatory reform, would make an already inefficient system far worse and could trigger unintended consequences that would harm both insurance company solvency and consumer protections.

Absent McCarran-Ferguson, any federal government agency could, on its own initiative, assert jurisdiction and issue regulations that affect the business of insurance. Since there is no single federal insurance law, these regulations would likely be uncoordinated and possibly contradictory. Layering this on top of the existing state system would create confusion, along with costs and compliance burdens that would seriously harm an industry whose companies and regulators are already struggling to modernize an outdated and inefficient system of regulation.

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[3] Report of the Joint Committee of the Senate and Assembly of the State of New York Appointed to Investigate the Affairs of Life Insurance Companies (1906). The Committee was named after State Senator William W. Armstrong. Charles Evans Hughes, later Chief Justice of the United States Supreme Court served as the Committee's Counsel.

Lawmakers concerned about McCarran-Ferguson must focus on both of its elements. Examination of the antitrust element must be coordinated with examination of the regulatory element. To do otherwise would invite regulatory inefficiency and jeopardize solvency and consumer protection.

As noted above, Congress is currently considering the need for a comprehensive overhaul of our present system of insurance regulation, with the principal focus of its inquiry being an optional federal insurance charter. Whether or not to allow for the chartering of national insurers will necessarily include consideration of McCarran-Ferguson. A system of federal insurance regulation might obviate the need for McCarran-Ferguson, but that will not necessarily be the case for insurers that elect to remain regulated by the states. In addition, there may be limited circumstances involving collective activities that Congress will wish to address with specific statutory language. In all events, the future of McCarran-Ferguson will likely be decided by Congress over the course of the next several years in the broader context of the future of insurance regulation. Given the timing of these legislative developments, we urge this Committee to refrain from taking specific action concerning McCarran-Ferguson at this time.

Reinstituting FTC authority over insurance activities will be duplicitous, with no benefits for consumers

Congress determined three decades ago to limit the ability of the Federal Trade Commission to investigate the business of insurance without explicit congressional authorization. Congress did this out of deference to the individual states and the NAIC to competently regulate the business of insurance, and to avoid any interference in or duplication of those efforts. We note that the same provision of the Federal Trade Commission Act that provides this limited constraint on FTC investigatory authority relative to insurance provides a blanket exemption from FTC investigations for all forms of depository institutions. We believe Congress made the right decision when it limited the FTC's authority, and we urge the Committee to keep this restriction in place. There is no evidence that the states and the NAIC are failing to pursue wrongdoing in the insurance industry. Reintroducing unlimited FTC authority will only serve to undermine state enforcement activities at unnecessary cost to the taxpayer.

As is the case with specific aspects of insurance regulation, Congress has the power today to override this limitation at any time. The FTC is empowered to investigate insurance activities if directed to do so by a majority of members of either the Senate Committee on Commerce, Science and Transportation or the Committee on Energy and Commerce of the House of Representatives[4].

We appreciate the opportunity to comment on S. 618, and look forward to working with Congress as it considers the future of the insurance regulatory structure.

Sincerely,

Gary E. Hughes
Executive Vice President & General Counsel

David Leifer
Senior Counsel

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[4] 15 U.S.C. 546(i).

Testimony of Dr. Michael M. Homan
Homeowner
New Orleans, LA

Chairman Leahy, Ranking Member Specter, and Members of the Committee, thank you for holding a hearing on this important issue and giving me the opportunity to share my story with you today. Like many in the Gulf Coast region, my family's lives were forever changed by Hurricane Katrina, and the devastation it brought to my city of New Orleans. But what brings me here today is the second personal tragedy that my family and I have suffered since Katrina because of the bad faith actions of Allstate Insurance.

My wife and I purchased our first house in New Orleans six years ago. We moved there from Jerusalem when I accepted a position to teach Theology at Xavier University. We were very attracted by what New Orleans and Louisiana had to offer, and we were also committed to giving back to the community. My wife teaches in the New Orleans Public Schools, where our children, Kalypso and Gilgamesh, are enrolled. Our home is in Mid-City, a great neighborhood in the heart of the city.

We were very happy living in New Orleans. We were employed with jobs that we loved, working to make New Orleans a better place, and at the same time we were building up equity in our beautiful 100-year-old home. However, our dreams were literally blown and washed away on August 29th of 2005, or to be more accurate, our dreams have died a slow death over the past 18 months because of Allstate Insurance. My wife, two children and I currently live in a FEMA trailer in the front yard of our collapsing home, as we continue to battle with Allstate over our insurance claim.

We insured everything we had with Allstate. This included homeowners, flood, and automobile insurance. They cashed every check we gave them. We slept well every night thinking that we were adequately insured with the self-designated "Good Hands" people. But we weren't in good hands.

On August 29, 2005, Hurricane Katrina ravaged New Orleans and our beautiful home. I was inside my house during the storm and it was like being on a large boat rocking back and forth from the wind gusts. The winds of hurricane Katrina racked our two-story house so that now it leans severely. The house next door to ours is also racked in the same direction.

Then later that night, after the levees failed, flood waters covered the first three feet of our house and this water remained for more than 10 days damaging the foundation and piers causing our house to lean even more. Right now as I speak, our home is in danger of falling onto our neighbor's house. We have been told by several experts not to gut the house, as it would likely fall over, because the plaster and lathe is helping to support it.

We filed our claim for wind and flood with Allstate the day after Katrina. We expected things to move along quickly, but we were wrong. We called Allstate every day for several months, and wrote them frequently, but we rarely received answers. They played a shell game with us, providing us with 10 different agents through this ordeal, and it took nine months to get a wind adjustor to even visit our house.

The third flood adjuster we had was the first person representing Allstate to visit us at our house. He arrived in October of 2005. He noticed, as do all people, that our house was recently racked, and he ordered an engineer from Allstate to assess whether it was racked from wind or flood. We knew it was wind, but didn't care either way, just as long as we received the funds to fix our home.

But then we waited and waited, and the engineers never showed up. We were told that everything hinged on that report, and we were told to be patient. The Allstate representatives all told us that the engineers would say it was racked from the flooding and we would be able to fix our home that way.

Several months passed, and we were running out of savings. We had to pay for our rent on top of our mortgage. We were insured so that Allstate would pay us "Additional Living Expenses" should our house be destroyed or be in an unlivable state like ours was; but Allstate said they wouldn't pay "Additional Living Expenses" until they received the engineer's report. In addition, FEMA would not give us rental assistance because we had "Additional Living Expenses" coverage with our insurance company. We clearly would have been better off if we had had no insurance, and we had never purchased a home.

Because of our financial situation, my family was forced to move into our structurally unsound home and spend nine months living in the upstairs portion that wasn't flooded. We had to live there through a cold winter without heat.

Finally in February of 2006 – after 6 months of phone calls and letters- two men from Haag Engineering arrived at our home. They spent 15 minutes in our house taking pictures, and then they left. We didn't hear anything until May 2006, when we received a letter from Allstate saying they were denying our claim for structural damage because of the Haag Engineer's report. I read the cover letter and report several times in disbelief, as we were left with a $150,000 mortgage for a property that before Katrina was worth $215,000, but now in its damaged state is worth about $30,000. We thought about declaring bankruptcy, but we didn't want to live with bad credit.

Fortunately for us, the Haag Engineer's report was full of mistakes. They called our house the Wilson house, and they included pictures in their report that weren't of our home. Their report actually claimed that the winds of Hurricane Katrina were not strong enough to rack a house, and at the end they even seemed to question whether or not our house flooded, even though the flood line is still visible nearly 3 feet above our floors and we have pictures of our house being under water.

My story is not unique. I've heard from dozens of other people in the same situation as us, where the insurance company hires an engineering firm to write the report they desire, and then they deny the claim. Thus the insurance company won't be liable since they relied on a so-called "expert" witness. Haag Engineering has a long history of doing this work for the insurance industry, as I later learned.

Now Allstate is doing all they can to leave the region and cancel their existing policies. We qualify for funds to raise our house three additional feet so that the floors are just above where the flood waters rested. But to do that, our house would have to be five feet off the ground, and Allstate would cancel our policy because they now won't insure any house more than four feet off the ground. Personally I would love to never write a check again to Allstate. All I want is for my home to be repaired and to have good insurance that my family can depend on.

My wife and I have kept an extensive journal documenting every phone conversation, unreturned calls and letters, and interactions we have had with Allstate Insurance. We filed a complaint with the Louisiana Insurance Commissioner James Donelon, and we have filed suit against Allstate in federal court. All we want is for Allstate to fix our house so that it is in the condition it was before Katrina. That's what our insurance policy says and that is what Allstate must abide by.

We believe that our situation exemplifies the immoral and unethical way which Allstate and other insurance companies are acting towards the citizens of the Gulf Coast. We are fighting back and have the truth and extensive documentation on our side. I am confident that in the end through the court system justice will prevail. But Allstate is counting on many people to give up from fatigue and frustration and to not fight back.

In conclusion, I want you to know that there are many people like me, who were responsible, careful and civic-minded, and who had insurance. But when the worst disaster in this country's history struck and severely damaged our insured home, Allstate purposefully waited eight months, and then told us that our insurance was basically worthless because of a fraudulent report. They need to be held accountable and they need to be forced to live up to their end of the contract.

Allstate, like other insurance companies in the Gulf Coast, is at times acting unethically, immorally, unjustly, and their actions are in violation of the laws of this great country. Thank you for your time and attention, and I hope that this committee will take action with people like my family in mind. Thank you.

Consumer Federation of America

TESTIMONY OF

J. ROBERT HUNTER,
DIRECTOR OF INSURANCE,
CONSUMER FEDERATION OF AMERICA

BEFORE

THE COMMITTEE ON THE JUDICIARY
OF THE
UNITED STATES SENATE

REGARDING

THE MCCARRAN-FERGUSON ACT: IMPLICATIONS OF REPEALING THE INSURERS' ANTITRUST EXEMPTION

March 7, 2007

Good morning Mr. Chairman and members of the Committee. Thank you for inviting me here today to discuss the need for the antitrust exemption of the McCarran-Ferguson Act. My name is Bob Hunter. I am the Director of Insurance for the Consumer Federation of America. CFA is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education. I am a former Federal Insurance Administrator under Presidents Ford and Carter and have also served as Texas Insurance Commissioner. I am also an actuary, a Fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries.

Today, nine national consumer organizations announce their wholehearted support of your legislation, S. 618, including CFA, the Center for Economic Justice, the Center for Insurance Research, the Center for Justice and Democracy, Consumers Union, the Foundation for Taxpayer and Consumer Rights, New Jersey Citizen Action, Public Citizen, and United Policyholders. The bill, which repeals the antitrust exemption enjoyed by the insurance industry and unleashes the Federal Trade Commission to protect insurance consumers, is critically needed to overcome the anticompetitive practices of this giant and important industry. It is high time that insurers played by the same rules of competition as virtually all other commercial enterprises operating in America's economy.

The McCarran-Ferguson Act is a truly astounding piece of legislation. The Act does two controversial things:

1. it delegates the regulation of insurance entirely to the states without providing any guidelines or standards for the states to meet and without mandating any continuing oversight by GAO or other federal entities, and

2. it largely exempts insurance companies from antitrust law enforcement, except for acts involving intimidation, coercion and boycott.

Both of these provisions are under review by Congress:

1. The delegation of regulation to the states is under attack by the insurance industry itself, parts of which seek an optional federal charter and parts of which seek federal preemption of state consumer protections. (A third segment of the industry supports the status quo.) Consumer representatives do not care who regulates insurance; they care only about the quality of consumer protections.[1] Both industry-sponsored proposals would accomplish something very hard to do given the overall inadequacy of consumer protection under the current state system – they would lower consumer protections.

2. The antitrust exemption has been ripe for repeal for decades with many businesses and consumers periodically seeking its end.

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[1] CFA's Principles for a solid regulatory system, be it federal or state, are attached to its testimony of October 22, 2003 before the Committee on Commerce, Science and Transportation of the U.S. Senate, available at http://www.consumerfed.org/pdfs/Insurance%20RegulationSenatetestimony10-03.pdf.

PERFECT TIMING FOR REPEAL

In 2004, the Property/Casualty Insurance industry set an industry record by netting an after tax profit of $40.5 billion[2]. In 2005, even considering Hurricane Katrina and other major hurricanes, the industry posted a profit of $48.8 billion[3] -- a new record. In 2006, with no major hurricane activity coupled with premium increases, the industry set yet another profit record, estimated to be $68.1 billion[4]. To put this into perspective the $157.4 billion in profit over the last three years equates to roughly $524 for every American, or $1,574 per household.[5]

At the same time, victims of Hurricane Katrina were having a remarkably hard time getting their claims settled and were, on top of that, starting to lose access to homeowners insurance as insurers pulled out of their area.

Collusive activities by the insurance industry contribute to this "perfect storm" that has harmed consumers. Consider the following anti-competitive activities, which are discussed at great length below:

- Claims were being settled under the outrageously unfair anti-concurrent-causation clause adopted simultaneously by many insurers. This contract provision prohibits consumers from filing a claim for wind damage if flood damage has occurred during the same period, even if the water damage occurred hours after the wind damage.
- Cartel-like organizations, such as the Insurance Services Office (ISO) were signaling to the market that it was time to cut back coverage in certain parts of the coast.
- Many insurers used identical or very similar claims processing systems that are designed to systematically underpay claims. These systems have frequently been recommended by common consultants.

BACKGROUND[6]

The history of the McCarran-Ferguson Act is replete with drama, from an industry flip-flopping on who should regulate it to skillful lobbying and manipulation of Congressional processes in order to transform the bill's short antitrust moratorium into a permanent antitrust exemption in the confines of a conference committee.

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[2] For a complete discussion of the industry's record profits in recent years and how it earned such remarkable returns in years of high hurricane activity, see "Property/Casualty Insurance in 2007: Overpriced Insurance, Underpaid Claims, Declining Losses and Unjustified Profits," by Americans for Insurance Reform, Center for Insurance Research, Center for Economic Justice, Consumer Federation of America, Consumers Union, Foundation for Taxpayer and Consumer Rights and United Policyholders, January 8, 2007. Online at: http://www.consumerfed.org/pdfs_2007Insurance_White_Paper.pdf

[3] The $40.5 and $48.8 billion dollar figures are from Aggregates and Averages, A. M. Best and Co., 2005 and 2006 editions.

[4] Review/Preview, A. M. Best and Co., January 2007.

[5] U.S. Census Bureau, Projections of the Number of Households and Families in the United States: 1995 to 2010.

[6] Much of this material is derived from the Report of the House Judiciary Committee on the Insurance Competitive Pricing Act of 1994 (House Report 103-853) dated October 7, 1994.

In fact, the insurance industry has long-standing anti-competitive roots. In 1819, local associations were formed to control price competition. In 1866, the National Board of Fire Underwriters was created to control price at the national level, but states enacted anti-compact legislation to control price fixing.

This increased state regulatory activity led insurers to seek a federal approach to preempt the state system. In 1866 and 1868, bills were introduced in Congress to create a national bureau of insurance, but the insurer effort was unsuccessful. Failing in Congress, the industry shifted to a judicial approach.

The case on which rode the industry's hope for court-initiated reform was Paul v. Virginia, 75 U.S. (8 Wall) 168 (1868). But the insurance industry's hopes were dashed when the Supreme Court ruled that states were not prohibited by the Commerce Clause from regulating insurance, reasoning that insurance contracts were not articles of commerce in any proper meaning of the word. Such contracts, they ruled, were not interstate transactions (though the parties may be domiciled in different states the policies did not take effect until delivered by the agent in a state, in this case Virginia). They were deemed, then, local transactions, to be governed by local law.

For the next 75 years, insurance regulation remained in the states, despite repeated insurance industry litigation seeking federal preemption. (Ironically, the industry would later adopt the Paul rationale to fend off enhanced federal scrutiny of its activities under the Sherman and Clayton Antitrust Acts).

Until 1944, state regulation of insurance was secure, based on the rationale that insurance was not interstate commerce. But that assumption was repudiated in the 1944 Supreme Court decision United States v. South-Eastern Underwriters Association. This case brought the insurance industry's swift return to Capitol Hill to seek exactly the opposite type of relief from what it had previously advocated for so long.

Three months after the Supreme Court denied a motion for a rehearing in South-Eastern Underwriters, Senators McCarran and Ferguson introduced a bill that would become the Act bearing their names. The bill was structured to favor continued state regulation of insurance, but also, ultimately, to apply the Sherman and Clayton Antitrust Acts when state regulation was inadequate.

Within two weeks of the bill's introduction, and without holding any hearings on the new measure, the Senate had passed it and sent it to the House of Representatives. As it was sent over, the McCarran-Ferguson Act provided only a very limited moratorium during which the business of insurance would be exempt from the antitrust laws.

The House Judiciary Committee also approved the bill without holding a hearing. The House floor debate indicates that House Members believed the language of the original bill already comported perfectly with the Senate amendment's stated goal of creating a limited moratorium during which the Sherman and Clayton Acts would not apply to the business of insurance.

However, despite the clear intent of both houses not to grant a permanent antitrust exemption, the conference committee proceeded to drastically transform the limited moratorium into a permanent antitrust exemption for the insurance industry. The new language provided that after January 1, 1948, the Sherman, Clayton, and Federal Trade Commission Acts "shall be applicable to the business of insurance to the extent that such business is not regulated by State law."

The House approved the conference report without debate. The sole expression of the House's intent regarding the conference report containing the new section 2(b) proviso is the statement of House managers of the conference, which indicates that they intended only to provide for a moratorium, after which the antitrust laws would apply. The Senate, in contrast, debated the conference report for two days. After repeated assurances that the proviso was not intended to preclude application of the antitrust laws, the Senate passed the bill, and President Roosevelt signed it into law on March 9, 1945.

The legislative history shows that the Senate had a serious debate on the antitrust exemption, unlike the House. Senator Claude Pepper contended that the new conference language enabled the states to evade the federal antitrust laws by mere authorizing legislation. Senator O'Mahoney stated that section 2(b) of the conference report simply provided for a moratorium, after which the antitrust laws would "come to life again in the field of interstate commerce." The "state action" doctrine of Parker v. Brown would apply fully, he said, so that "no State, under the terms of the conference report, could give authority to violate the antitrust laws." Therefore, he concluded, "the apprehensions which [Senator Pepper] states with respect to the conference report are not well founded." Senator McCarran likewise reassured Senator Pepper that "he is in error in his whole premise in this matter."

Unfortunately, the courts construing the Act did not make these inferences. When presented with the question of what Congress meant by "regulated," the courts found no standard in the text of the statute and, declining to search for one in the legislative history, reached the very conclusion that Senator Pepper had anticipated and vainly struggled to forestall.

The antitrust exemption has been studied on several occasions by federal authorities, each time with the determination that continued exemption was not warranted. For example:

- In 1977, when I was Federal Insurance Administrator under President Ford, the Justice Department concluded, "an alternative scheme of regulation, without McCarran Act antitrust protection, would be in the public interest."[7]

- In 1979, President Carter's National Commission for the Reform of Antitrust Laws and Procedures concluded, almost unanimously, that the McCarran broad antitrust immunity should be repealed.

- In 1983, then FTC Chairman James C. Miller III told the House Subcommittee on Commerce, Transportation and Tourism that he saw no legitimate reason to exempt the insurance industry from FTC jurisdiction.

[7] Report of the U.S. Department of Justice to the Task Group on Antitrust Immunities, 1977.

- In 1994, the House Judiciary Committee issued its report calling for a sharp cutting back of the antitrust exemption.

ATTORNEY GENERAL SPITZER'S FINDINGS

The nation was shocked when it learned that New York Attorney General Elliot Spitzer had uncovered remarkable levels of anticompetitive behavior involving the nation's largest insurance companies and brokers. The victims were the most sophisticated insurance consumers of all – major American corporations and other large buyers. Bid-rigging, kickbacks, hidden commissions and blatant conflicts of interest were uncovered. Attorney General Spitzer's findings are, unfortunately, a reflection of the deeply rooted anti-competitive culture that exists in the insurance industry. Only a complete assessment of the federal and state regulatory failures that have helped create and foster the growth of this culture will help Congress understand how to take effective steps to change it.

On the federal side, the antitrust exemption that exists in the McCarran-Ferguson Act (and that is modeled by many states) has been the most potent enabler of anticompetitive practices in the insurance industry. Congress has also handcuffed the Federal Trade Commission in prosecuting and even in investigating and studying deceptive and anticompetitive practices by insurers and brokers. On the state side, insurance regulators have utterly failed to protect consumers and to properly regulate insurers and brokers in a number of key respects. Many of these regulators, for example, collaborated with insurance interests to deregulate commercial insurance transactions, which further hampered their ability to uncover and root out the type of practices uncovered by Attorney General Spitzer. Deregulation coupled with an antitrust exemption inevitably leads to disastrous results for consumers.

The Spitzer investigation reveals how easily sophisticated buyers of insurance can be duped by brokers and insurers boldly acting in concert in a way to which they have become accustomed over the long history of insurance industry anticompetitive behavior. Imagine the potential for abuse and deceit when small businesses and individual consumers try to negotiate the insurance marketplace, if sophisticated buyers are so easily harmed.[8]

WIDE RATE DISPARITY REVEALS WEAK COMPETITION IN INSURANCE

Consider the wide disparities in automobile insurance rate quotes that a thirty-five year old married man in Philadelphia with a clean driving record would receive.[9] Allstate would quote as much as $12,493 for this coverage; Erie Insurance Exchange (an insurer with a better service record than Allstate) would charge $2,500.[10] A 20-year old in Burlington, Vermont with no accidents or tickets could pay as much as $4,728 from Union Mutual or as low as $1,164 from

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[8] For a complete discussion of the anticompetitive activities uncovered by Attorney General Spitzer, see Statement of J. Robert Hunter before the Senate Committee on Governmental Affairs on November 16, 2004 in the hearing entitled, "Oversight Hearing on Insurance Brokerage Practices, Including Potential Conflicts of Interest and the Adequacy of the Current Regulatory Framework."

[9] To insure a four-door, 2003 Ford Taurus SE equipped with air bags, anti-lock brakes and a passive anti-theft device for someone who drives to work five miles one way and 12,000 miles annually and seeks insurance for $50,000/$100,000/$5,000 (BI/PD limits) and comprehensive coverage with a $250 deductible.

[10] "Buyers Guide for Auto Insurance." Downloaded from the Pennsylvania Insurance Department website on May 12, 2006.

Hartford. Sentinel Insurance Company.[11]

Some would say this wide range in price proves a competitive market. It does not. A disparity like this, where prices for the exact same person can vary by a multiple of five, reveals very weak competition in the market. In a truly competitive market, prices fall in a much narrower range around a market-clearing price at the equilibrium point of the supply/demand curve.

There are a number of important reasons why competition is weak in insurance. Several have to do with the consumer's ability to understand insurance:

1. ***Complex Legal Documents.*** Most products are able to be viewed, tested, "tires kicked" and so on. Insurance policies, however, are difficult for consumers to read and understand -- even more difficult than documents for most other financial products. For example, consumers often think they are buying insurance, only to find they've bought a list of exclusions. No where was this more apparent than after Hurricane Katrina...consider ISO's "Anti-concurrent-causation Clause" as a prime example of joint decision making that harmed consumers. This confusing clause was intended, believe it or not, to eliminate a covered coverage (in Katrina, wind damage) when a non-covered coverage occurs (flood), even later. So, the industry colluded to create a clause that no reasonable person could logically understand, to the detriment of consumers and the rebuilding efforts in the Gulf region. An example is a wind seriously destroys a home, followed by a much later storm surge finishing off the home...this is no coverage, the industry alleges.

2. ***Comparison Shopping is Difficult.*** Consumers must first understand what is in the policy to compare prices.

3. ***Policy Lag Time.*** Consumers pay a significant amount for a piece of paper that contains specific promises regarding actions that might be taken far into the future. The test of an insurance policy's usefulness may not arise for decades, when a claim arises.

4. ***Determining Service Quality is Very Difficult.*** Consumers must determine service quality at the time of purchase, but the level of service offered by insurers is usually unknown at the time a policy is bought. Some states have complaint ratio data that help consumers make purchase decisions, and the NAIC has made a national database available that should help, but service is not an easy factor to assess.

5. ***Financial Soundness is Hard to Assess.*** Consumers must determine the financial solidity of the insurance company. They can get information from A.M. Best and other rating agencies, but this is also complex information to obtain and decipher.

6. ***Pricing is Dismayingly Complex.*** Some insurers have many tiers of prices for similar consumers—as many as 25 tiers in some cases. Consumers also face an array of classifications that can number in the thousands of slots. Online assistance may help

[11] "Buyers Guide for Auto Insurance." Downloaded from the Vermont Insurance Department website on March 2, 2007.

consumers understand some of these distinctions, but the final price is determined only when the consumer actually applies and full underwriting is conducted. At that point, the consumer might be quoted a rate quite different from what he or she expected. Frequently, consumers receive a higher rate, even after accepting a quote from an agent.

7. ***Underwriting Denial.*** After all that, underwriting may result in the consumer being turned away.

Other impediments to competition rest in the market itself:

8. ***Mandated Purchase.*** Government or lending institutions often require insurance. Consumers who must buy insurance do not constitute a "free-market," but a captive market ripe for arbitrary insurance pricing. The demand is inelastic.

9. ***Producer Compensation is Unknown.*** Since many people are overwhelmed with insurance purchase decisions, they often go to an insurer or an agent and rely on them for the decision making process. Hidden commission arrangements may tempt agents to place insureds in the higher priced insurance companies. Contingency commissions may also bias an agent or broker's decision making process. Elliott Spitzer's investigations showed that even sophisticated insurance buyers could not figure this stuff out.

10. ***Incentives for Rampant Adverse Selection.*** Insurer profit can be maximized by refusing to insure classes of business (e.g., redlining) or by charging regressive prices. Profit can also be improved by offering kickbacks in some lines such as title and credit insurance.

11. ***Antitrust Exemption.*** Insurance is largely exempt from antitrust law under the provisions of the McCarran-Ferguson Act. Repeal of this outdated law is seriously under consideration in Congress.

Compare shopping for insurance with shopping for a can of peas. When you shop for peas, you see the product and the unit price. All the choices are before you on the same shelf. At the checkout counter, no one asks where you live and then denies you the right to make a purchase. You can taste the quality as soon as you get home and it doesn't matter if the pea company goes broke or provides poor service. If you don't like peas at all, you need not buy any. By contrast, the complexity of insurance products and pricing structures makes it difficult for consumers to comparison shop. Unlike peas, which are a discretionary product, consumers absolutely require insurance products, whether as a condition of a mortgage, as a result of mandatory insurance laws, or simply to protect their home, family or health.

COMPETITION CAN BE ENHANCED BY REPEAL OF THE ANTITRUST EXEMPTION

The insurance industry, as documented by the history recounted above, arose from cartel roots. For centuries, property/casualty insurers have used so-called "rating bureaus" to make rates for several insurance companies to use. Not many years ago, these bureaus required that insurers charge rates developed by the bureaus (the last vestiges of this practice persisted into the 1990s).

In recent years, the rate bureaus have stopped requiring the use of their rates or even preparing full rates because of lawsuits by state attorneys general after the liability crisis of the mid-1980s was caused, in great part, by insurers sharply raising their prices to return to ISO rate levels. ISO is an insurance rate bureau or advisory organization. Historically, ISO was a means of controlling competition. It still serves to restrain competition since it makes "loss costs" (the part of the rate that covers expected claims and the costs of adjusting claims) which represent about 60-70 percent of the rate. ISO also makes available expense data to which insurers can compare their costs in setting their final rates. ISO sets classes of risk that are adopted by many insurers. ISO diminishes competition significantly through all of these activities. There are other such organizations that also set pure premiums or do other activities that result in joint insurance company decisions. These include the National Council on Compensation Insurance (NCCI) and National Insurance Services Organization (NISS). Examples of ISO's many anticompetitive activities are attached as Attachment A.

Today, the rate bureaus still produce joint price guidance for the large preponderance of the rate. The rating bureaus start with historic data for these costs and then actuarially manipulate the data (through processes such as "trending" and "loss development") to determine an estimate of the projected cost of claims and adjustment expenses in the future period when the costs they are calculating will be used in setting the rates for many insurers. Rate bureaus, of course, must bias their projections to the high side to be sure that the resulting rates or loss costs are high enough to cover the needs of the least efficient, worst underwriting insurer member or subscriber to the service.

Legal experts testifying before the House Judiciary Committee in 1993 concluded that, absent McCarran-Ferguson's antitrust exemption, manipulation of historic loss data to project losses into the future would be illegal (whereas the simple collection and distribution of historic data itself would be legal – which is why you do not need safe harbors to protect pro-competitive joint activity). This is why there are no similar rate bureaus in other industries. For instance, there is no CSO (Contractor Services Office) predicting the cost of labor and materials for construction of buildings in the construction trades for the next year (to which contractors could add a factor to cover their overhead and profit). The CSO participants would go to jail for such audacity.

Further, rate organizations like ISO file "multipliers" for insurers to convert the loss costs into final rates. The insurer merely has to tell ISO what overhead expense load and profit load they want and a multiplier will be filed. The loss cost times the multiplier is the rate the insurer will use. An insurer can, as ISO once did, use an average expense of higher cost insurers for the expense load if it so chooses plus the traditional ISO profit factor of five percent and replicate the old "bureau" rate quite readily.

It is clear that the rate bureaus[12] still have a significant anti-competitive influence on insurance prices in America.

- The rate bureaus guide pricing with their loss cost/multiplier methods.
- The rate bureaus manipulate historic data in ways that would not be legal absent the McCarran-Ferguson antitrust law exemption.
- The rate bureaus also signal to the market that it is OK to raise rates. The periodic "hard" markets are a return to rate bureau pricing levels after falling below such pricing during the "soft" market phase.
- The rate bureaus signal other market activities, such as when it is time for a market to be abandoned and consumers left, possibly, with no insurance.

CURRENT EXAMPLES OF THE COLLUSIVE NATURE OF INSURANCE – HOME INSURANCE AVAILABILITY AND PRICING IN THE WAKE OF HURRICANE KATRINA

As an example of coordinated behavior that would end if antitrust laws applied fully to insurers, consider the current situation along America's coastlines. Hundreds of thousands of people are having their homeowners insurance policies cancelled and prices are skyrocketing. As to the decisions to non-renew, on May 9, 2006 the ISO President and CEO Frank J. Coyne signaled that the market is overexposed along the coastline of America. In the *National Underwriter* article, "Exposures Overly Concentrated Along Storm-prone Gulf Coast" (May 15, 2006 Edition), the ISO executive "cautioned that population growth and soaring home values in vulnerable areas are boosting carrier exposures to dangerous levels." He said, "The inescapable conclusion is that the effects of exposure growth far outweigh any effects of global warming."

Insurers have undertaken major pullbacks in the Gulf Coast in the wake of the ISO pronouncement. On May 12, 2006, Allstate announced it would drop 120,000 home and condo policies and State Farm announced it would drop 39,000 policies in the wind pool areas and increase rates more than 70 percent.[13] An update of this information, based on an article in the *Los Angeles Times* follows this testimony as Attachment C.

Collusion appears to be involved in price increases along our nation's coastline as well. On March 23, 2006, Risk Management Solutions (RMS) announced that it was changing its hurricane model upon which homeowners and other property/ casualty insurance rates are based. RMS said that "increases to hurricane landfall frequencies in the company's U.S. hurricane model will increase modeled annualized insurance losses by 40% on average across the Gulf Coast, Florida and the Southeast, and by 25-30% in the Mid-Atlantic and Northeast coastal regions, relative to those derived using long-term 1900-2005 historical average hurricane

[12] By "rate bureaus" here I include the traditional bureaus (such as ISO) but also the new bureaus that have a significant impact on insurance pricing such as the catastrophe modelers (including RMS), other non-regulated organizations that impact insurance pricing and other decisions across many insurers (credit scoring organizations like FAIR Isaac are one example) and organizations that "assist" insurers in settling claims, like Computer Sciences Corporation (using products like Colossus).

[13] "Insurers Set to Squeeze Even Tighter," *Miami Herald*, May 13, 2006.

frequencies." This means that the hurricane component of insurance rates will sharply rise, resulting in overall double-digit rate increases along America's coastline from Maine to Texas.

The RMS action interjects politics into a process that should be based solely on sound science. In the aftermath of the unexpectedly high damage caused by Hurricane Andrew, insurers turned to computer catastrophe modelers like RMS for new approaches to setting rates for catastrophe insurance coverage. The new method was a computer simulation model based on either a 1,000 or 10,000-year weather forecast. Consumers were told that the increase in rates resulting from the new computer catastrophe models would lead to greater rate stability. (I was promised this outcome personally when I was Texas Insurance Commissioner.) There would be no need to raise rates after a catastrophic weather event with the use of the new models, insurers said, because these storms would already have been anticipated when rates were set. However, the new RMS model breaks that promise to consumers and establishes rates on a five-year time horizon, which is expected to be a period of higher hurricane activity.

RMS has become the vehicle for collusive pricing. In its report on its new hurricane model, RMS states:

> In developing the new medium-term five-year view of risk, RMS has taken counsel from representatives across the insurance industry in determining that future model output will be for a 'medium-term' five-year risk horizon.[14]
>
> To determine what should be the explicit risk horizon of an RMS Cat model, opinions were solicited among the wider insurance industry from those who both use and apply the results of models to find the duration over which they sought to characterize risk.[15](Emphasis added)

It is clear from the release that insurance companies sought this move to higher rates. RMS's press release of March 23, 2006 states:

> Coming off back-to-back, extraordinarily active hurricane seasons, the market is looking for leadership. At RMS, we are taking a clear, unambiguous position that our clients should manage their risks in a manner consistent with elevated levels of hurricane activity and severity,' stated Hemant Shah, president and CEO of RMS. 'We live in a dynamic world, and there is now a critical mass of data and science that point to this being the prudent course of action.

The "market" (the insurers) sought leadership (higher rates), so RMS was in a competitive bind. If it did not raise rates, the market would likely go to modelers who did. So RMS acted and the other modelers are following suit. According to the *National Underwriter's* Online Service (March 23, 2006): "Two other modeling vendors—Boston-based AIR Worldwide and Oakland, Calif.-based Eqecat—are also in the process of reworking their hurricane models." It is shocking and unethical that scientists at these modeling firms, under pressure from insurers, appear to have completely changed their minds *at the same time* after over a decade of using models they assured the public were scientifically sound.

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[14] Risk Management Solutions, "U.S. and Caribbean Hurricane Activity Rates," March 2006, page 1.
[15] Risk Management Solutions, "U.S. and Caribbean Hurricane Activity Rates," March 2006, page 4.

The RMS model is now coming under increasing scientific and political scrutiny. According to a report in the *Tampa Tribune*,

> Two scientists, Florida State University geologist Jim Elsner and National Oceanic and Atmospheric Administration research meteorologist Thomas R. Knutson, told the Tribune that insurance industry objectives drove the change and faulted the company's scientific justification…'I'm kind of used to deceptive activity as a former attorney general,' (Governor) Crist said. 'But that was rather disturbing to hear about that. We need to get as much information as we possibly can. This much I do know: Insurance companies are making extraordinary profits.'[16]
>
> Other scientists have also expressed concerns about the RMS methodology.
>
> 'It's ridiculous from a scientific point of view. It just doesn't wash well in the context of the way science is conducted,' said Mark S. Frankel, director of the Scientific Freedom, Responsibility & Law Program at the American Association for the Advancement of Science, in Washington. (RMS) mentioned the 'expert elicitation' process RMS conducted in October 2005 - when the company paid the expenses for four scientists to meet in Bermuda and discuss the issue. The company later mentioned the scientists in news releases and included pictures of them in a slideshow on the new model. Last week, two of those scientists told the Tribune they didn't agree with some of the statements RMS has made about the model and noted that they only had a chance to review a portion of the data in question…'I think that question was driven more by the needs of the insurance industry as opposed to the science,' said Knutson, who also questioned the extent of some of the RMS projections about hurricane landfall.[17]

Insurers often try to position supposedly objective and independent third parties as the public decision-makers when it is insurers themselves who want to increase rates. For decades, the third parties that often performed this function were ratemaking (advisory) organizations such as ISO. At least ISO and other rating organizations were licensed by the states and subject to at least nominal regulation, because of the important impact they had on rates and other insurance tools, such as policy forms.

More recently, insurers have utilized new third party organizations (like RMS) to provide information (often from "black boxes" beyond state insurance department regulatory reach) for key insurance pricing and underwriting decisions, which helps insurers to avoid scrutiny for their actions. These organizations are not regulated by the state insurance departments and have a huge impact on rates and underwriting decisions with no state oversight. RMS is one such

[16] "Christ, Sink Seek Storm Model Data," *Tampa Tribune*, January 9, 2007

[17] " Ethicist Questions Insurance Rate Data," *Tampa Tribune*, January 12, 2007.

organization. Indeed RMS's action, since it is not a regulated entity, may be a violation of current antitrust laws.

POSSIBLE COLLUSION ON CLAIMS PRACTICES

Many concerns have been raised about the poor performance of property-casualty insurers in paying legitimate claims in the wake of Hurricane Katrina. Some have suggested that the lack of attention to individual claims by some insurers may have been the result of the collusion. Consider this startling blog from the President of the Association of Property/Casualty Claims Professionals, James Greer, posted on the web site of the Editor of the National Underwriter:

Posted on January 31, 2007 23:06

James W. Greer, CPCU:
Although I live and work in Florida, my home is on the Mississippi Gulf Coast where I have family spread from one side of the state to the other. I spent six months there leading a team of over 100 CAT adjusters and handling the wind claims for the state's carrier of last resort.

I personally walked through the carnage, saw the people, and felt the sorrow. I climbed the roofs, measured the slabs, and personally witnessed very visible and clear damage caused by both water AND WIND.

I also observed something else that surprised me, and, after 28 years as a claims professional who has carried "the soul" of a bygone industry in my practices and preachings, I was ashamed of those to whom I had vested a lifetime career: An overwhelming lack of claims adjusters on the Mississippi Gulf Coast. The industry simply did not respond.

The industry appeared as distant to the Miss. Gulf Coast as the federal government was accused of being to New Orleans. *It was as if some small group of high-level financial magnates decided that the only way to save the industry's financial fate from this mega-disaster was to take a total hand's off approach and hide beneath the waves and the flood exclusion.*

While media reps repeatedly quoted, "Each claim is different and will be handled on its own facts and merits," the carriers behaved as one...if there was evidence of water, or you were within a certain geographic boundary, adjusters were largely absent on the coast. (Emphasis added.)

(Actually, State Farm did have one of the largest CAT facilities, located centrally on the coast, but there was little evidence of other carrier presence.)

I personally observed large carriers simply refusing to respond, or even consider arguments of wind involvement...well-rationalized sets of facts, coverage and legal arguments. The silence from industry officials "far from the field" who retained the authority for claim decision-making was deafening.

In an article posted on the Association of Property & Casualty Claims Professionals' Web site shortly after Katrina hit, I described the catastrophe as "Claims Greatest Challenge," and pondered the industry would respond. Now we know.

As a member of an old Aetna family that has been widely dispersed since its demise in the '90's, I remember the day when leaders of that fine company routinely cited, and tried to honor, the social/moral contract the insurance industry had with society. It is clear that, in today's business environment, the soul of the insurance industry is missing, and despite the rhetoric of its PR machine, the industry no longer recognizes such a social/moral obligation.

As a lifetime claims professional, I will never quit writing, teaching and showing those who are interested the way things should be done to serve the best interests of the industry and its customers according to the best practices and behaviors of a bygone claims age. Perhaps someday a change in mindset will once again begin to evolve.

Clearly, for the Mississippi Gulf Coast, the Katrina catastrophe, the animosity and the litigation, it was never really about flood...nor was it about the flood exclusion. It was, and is, about the failure of the insurance industry to keep its promise...a promise that it will respond when loss occurs.

The only thing sold in insurance is peace of mind. The victims of this storm, and certainly those in Mississippi, will never again find peace of mind in insurance.

Actions do speak loudest. On the Mississippi Gulf Coast, the insurance industry simply failed to act. In the end, it will pay dearly for that decision, as will all of society.

James W. Greer, CPCU, President, Association of Property & Casualty Claims Professionals (PCCP)[18]

There may also be significant antitrust implications to the growing use of claims payment software by insurance companies. Insurers have reduced their payouts and maximized their profits by turning their claims operations into "profit centers" by using computer programs and other techniques designed to routinely underpay policyholder claims. For instance, many insurers are using programs such as "Colossus," sold by Computer Sciences Corporation (CSC.)[19] CSC sales literature touted Colossus as 'the most powerful cost savings tool" and also suggested that the program will immediately reduce the size of bodily injury claims by up to 20 percent. As reported in a recent book, "...any insurer who buys a license to use Colossus is able to calibrate the amount of 'savings' it wants Colossus to generate...If Colossus does not generate sufficient 'savings' to meet the insurer's needs or goals, the insurer simply goes back and 'adjusts' the benchmark values until Colossus produces the desired results."[20] In a settlement of a class-action lawsuit, Farmers Insurance Company has agreed to stop using Colossus on uninsured and underinsured motorist claims where a duty of good faith is required and has agreed to pay class members cash benefits.[21] Other lawsuits have been filed against most of America's leading insurers for the use of these computerized claims settlement products.[22]

Programs like Colossus are designed to systematically underpay policyholders without adequately examining the validity of each individual claim. The use of these programs severs the promise of good faith that insurers owe to their policyholders. Any increase in profits that results cannot be considered to be legitimate. Moreover, the introduction of these systems could explain part of the decline in benefits that policyholders have been receiving as a percentage of premiums paid in recent years.

[18] "Your Own Worst Enemy, Continued," Blog of Sam Friedman, Editor, National Underwriter Magazine, www.property-casualty.com, February 21, 2007. The blog has other interesting posts on this subject.
[19] Other programs are also available that promise similar savings to insurers, such as ISO's "Claims Outcome Advisor." These are bodily injury systems but other systems, such as Exactimate, "help" insurers control claims costs on property claims.
[20] "From Good Hands to Boxing Gloves – How Allstate Changed Casualty Insurance in America," Trial Guides, 2006, Berardinelli, Freeman and DeShaw, pages 131, 133, 135.
[21] Bad Faith Class Actions, Whitten, Reggie, PowerPoint Presentation, November 9, 2006.
[22] Ibid.

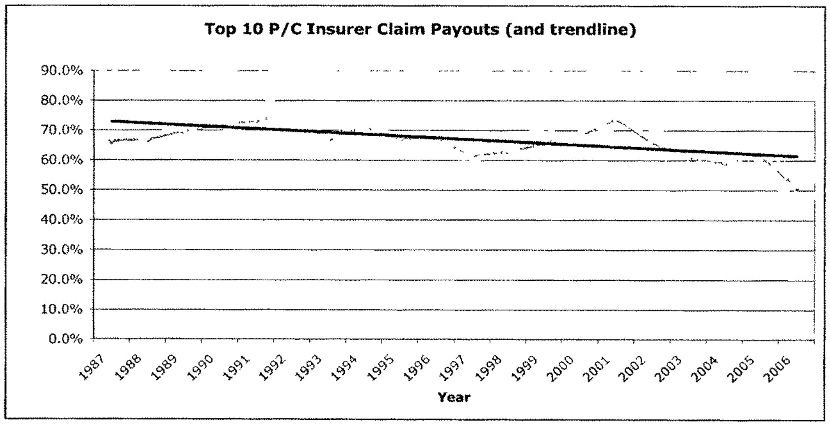
Colossus is being used by most major insurance companies, in some cases through the marketing efforts of CSC offering 20 percent savings. McKinsey & Company has also encouraged several companies to use Colossus[23]. "Before the Allstate project in 1992 (called CCPR – Claims Core Process Redesign), McKinsey named its USAA project 'PACE' [Professionalism and Claims Excellence]. At State Farm, McKinsey named its project 'ACE' [Advanced Claims Excellence]."[24]

For example, McKinsey introduced Allstate to Colossus. "McKinsey already knew how Colossus worked having proved it in the field at USAA."[25] This quote was footnoted as follows: "See McKinsey at (PowerPoint slide number) 7341: "The Colossus sites have been extremely successful in reducing severities with reductions in the range of 10% for Colossus-evaluated claims."[26]

I have been a witness in some of the cases against insurers using the Colossus product and I am covered by a protective order in these cases (I could go on at length about why these Protective Orders are a bad public policy, particularly coupled with secrecy provisions in settlements, in that the bad practice that was uncovered often continues to harm people). I am, therefore, limited in this testimony to what is in the public domain. However, as I describe above, there is public information about the use of common consultants and vendors by insurance companies that have adopted Colossus and similar systems. I strongly urge this committee to probe the question of whether these vendors and consultants have been involved in encouraging and facilitating collusive behavior by insurance companies with these claims systems. I also urge you to investigate whether a similarity in Hurricane Katrina claims payment procedures and actions (or non-actions), as mentioned above, could indicate collusive activity by some insurers.

The use of these products to cut claims payouts may be at least part of the reason that consumers are receiving record low payouts for their premium dollars as insurers reap unprecedented profits. As is obvious in the following graph, the trend in payouts is sharply down over the last twenty years, a period during most state insurance regulators have allowed consumer protections to erode significantly and when Colossus and other claims systems were being introduced by many insurers.[27]

[23] "...Mc Kinsey & Co. has taught Allstate **and other** insurance companies how to deliver less and less." Berardinelli, Freeman and DeShaw, page 17.
[24] Ibid. Page 57.
[25] Ibid. Page 132.
[26] Ibid.
[27] CFA tested this drop in benefits related to premiums to see if it could be attributed to a drop in investment income. Over the time frame studied, there was a three percent drop in investment income. Since insurers typically reflect about half of investment income in prices, CFA believes that the drop in investment income accounts for only 1.5 points of the 15-point drop. That is, investment income explains only about one-tenth of the drop in benefit payouts to consumers per dollar expended in insurance premium.



It is truly inappropriate for property/casualty insurers to be delivering only half of their premium back to policyholders as benefits.[28]

The state insurance departments have been sound asleep on the issue of Colossus and other such models being sold and severely impacting policyholder rights to fair, even good faith claims settlements. If the FTC had been empowered to undertake investigations and other consumer protection activities, the insurers might have thought twice about engaging in such acts on a national basis.

INEFFICIENCY HARMS CONSUMERS

Because of market inefficiencies, exacerbated by the collusion allowed by the McCarran-Ferguson antitrust exemption, high expense insurers with commensurate high prices can charge whatever is needed to cover their inefficient operations or even more and, like Allstate in Philadelphia, still retain significant market share.

Inefficiency abounds in insurance, as the chart above reveals and as is documented further in the attached spreadsheet. (Attachment B). If competition was more effective, significant cost savings (savings in the double digits) could be expected. The spreadsheet contains data compiled by AM Best and Co. showing expenses as a ratio of premiums for all major insurers and aggregate expense information for the entire property/casualty insurance industry.

The first three columns of numbers are the expenses for the entire industry. The spreadsheet shows, by major line of insurance, the loss adjustment expense and the underwriting expenses and the total of these two expense ratios. The loss adjustment expense is the cost of

[28] Insurers contend that the loss adjustment expense is a benefit to consumers. Obviously, this is a "benefit" that does not go to the consumer or repair cars, doctor bills, etc. But even the loss and LAE ratio itself is at a record low for many decades, at under 70 percent.

settling claims, including defense attorney costs, adjusters' costs and other claim-related expenses. The underwriting expense includes the costs of policy writing, agent and broker costs, overhead costs and other business expenses, with the exception of loss adjustment costs.

The next three columns show similar data but for a specific efficient and large (at least one percent of the national premiums in the line of insurance shown) insurance company.

The final two columns are calculations made by CFA to show the potential savings if competition were enhanced. The first of the two columns shows the savings that would occur if the average expense ratio of all insurance companies were lowered to that ratio enjoyed by an efficient insurer. The final column on the spreadsheet shows the savings that would occur if the expense ratio of the inefficient insurer were lowered to the average expense ratio of all insurance companies.

CFA believes that application of antitrust laws to the insurance industry could result in double-digit savings for America's insurance consumers. Our study shows remarkable potential benefits for consumers if the antitrust exemption is removed and states do a better job of regulating insurers.

ELIMINATING THE ANTITRUST EXEMPTION HAS HELPED CONSUMERS IN CALIFORNIA

The insurance industry would have us all believe that competition and regulation are polar opposites. This is not true. Both competition and regulation seek the same end, the lowest possible prices for consumers consistent with fair profits for the providers of a good or service. They can work together in a complimentary fashion.

The proof that competition and regulation can work together in a market to benefit consumers and the industry is the manner in which California regulates auto insurance under Proposition 103. Indeed, that was the intent of the drafters of Proposition 103. Before Proposition 103, Californians had experienced significant price increases under a system of "open competition." Proposition 103 sought to maximize competition by eliminating the state antitrust exemption, laws that forbade agents to compete, laws that prohibited buying groups from forming, and so on. It also imposed the best system of prior approval of insurance rates and forms in the nation, with very clear rules on how rates would be judged.

As our in-depth study of regulation by the states revealed,[29] California's regulatory transformation – to rely on both maximum regulation and competition – has produced remarkable results for auto insurance consumers and for the insurance companies doing business there. The study reported that insurers realized very substantial profits, above the national average, while consumers saw the average price for auto insurance drop from $747.97 in 1989, the year Proposition 103 was implemented, to $717.98 in 1998. Meanwhile, the average premium rose nationally from $551.95 in 1989 to $704.32 in 1998. California's rank dropped from the third costliest state to the 20th.

[29] "Why Not the Best? The Most Effective Auto Insurance Regulation in the Nation," June 6, 2000, (www.consumerfed.org).

I can update this information through 2003.[30] As of 2003, the average annual premium in California was $832.69 (ranked 19th) vs. $837.88 for the nation. Since California transitioned from relying simply on competition -- as promoted by insurers -- to full competition and regulation, the average auto rate went up by 11.3 percent while the national average rose by 51.8 percent -- a powerhouse result for California's consumers! [31]

Removing the antitrust exemption has been a key element in this successful transformation of California's insurance market.

BROOKS HEARINGS

I encourage you to carefully review materials from the last time Congress studied this matter: the hearings and report developed under Chairman Jack Brooks of the House Judiciary Committee in the early to mid 1990s. You will find that a long list of organizations supported reform: from labor to business, from consumer groups to the ABA.

In 1994, the House Judiciary Committee issued its report. A compromise proposal emerged after years of negotiation that both we at CFA and the American Insurance Association (AIA) supported. It would have only controlled trending by insurers where groupings of "rivals" in bureaus like ISO cooperated in the ratemaking process to project pricing into the future. The compromise would have also prohibited joint final price fixing, allowed today. The idea was to end the situation under McCarran where a state law on the books – no matter how weak or unenforced – trumps federal antitrust enforcement. This system, which produces extremely weak consumer protection results, would be replaced by the more normal American system known as the state action doctrine, which would require active supervision by a state that wanted to allow collusive behavior in the insurance market.

That would have been a good step forward in 1994, so we agreed to the compromise. In the intervening years, we have had another hard market made possible by Congressional inaction on McCarran reform. We have had shocking revelations by Attorney General Spitzer of bid rigging and kickbacks, where the most sophisticated insurance buyers were duped. We have the remarkable Katrina related revelations of claims practices, group adoption of anti-concurrent-causation clauses and the creation of a coastal crisis in the midst of the industries unprecedented prosperity. We have seen reverse competition, where kickbacks to intermediaries have caused extreme increases in prices of title insurance, credit insurance and other lines.

Given these new outrages, CFA believes that the compromise we agreed to in 1994 would be too little, too late in 2007. We now believe that only a complete repeal of the antitrust exemption, such as that embodied in S. 618, will achieve the reforms that are necessary to end these anticompetitive abuses.

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[30] State Average Expenditures & Premiums for Personal Automobile Insurance in 2001, NAIC, July 2005.

[31] Insurers have posted excellent profits as well. Over the decade ending in 2004, California insurers enjoyed a return on equity for private passenger auto insurance of 11.1 percent vs. 8.5 percent for the nation (Report on Profitability by Line by State 2004, NAIC).

RESPONSE TO INSURER ARGUMENTS AGAINST REPEAL

CFA has heard several concerns from the insurance industry regarding repeal of the McCarran Ferguson Act that do not withstand serious scrutiny.

1. Small insurers would be hurt by the lack of data sharing. There is absolutely no evidence for this claim. As stated above, legal experts have testified that pro-competitive activities, such as the collection and dissemination of historic data, would still be legal under current antitrust laws. It is true that some companies would have to hire actuarial services to replace the joint actions for such anti-competitive steps as trending, but many actuaries are available for hire to do such work. If a state wanted to replicate some process, such as joint trending, it could do so under the state action doctrine. The difference would be that the state would have to be actively involved in regulating such activities. This would be a great step forward for consumers, since many states today provide very little oversight.

2. Small insurers would be hurt by the lack of joint policy language. It is not appropriate to allow cartel-like organizations to write "joint" policy language for adoption by many insurers in a short period of time. Such an approach leads inevitably to the wide adoption of anti-consumer provisions, like the anti-concurrent-causation clause. The financial impact of developing standardized policy language on smaller insurers could be mitigated if state insurance departments promulgate standard forms. However, these regulators would have to ensure that the policy language was fair to consumers, not just friendly to insurers.

3. ISO and other Cartel-like organizations "facilitate" competition. This claim is patently absurd, as every independent study over the last few decades has shown. (See studies cited above.) If industry-wide collusion to develop prices is pro-competitive, why has Congress and the courts determined that such activity send executives in other industries to jail?

4. Allowing the FTC to study insurance issues would cause a "lawsuit explosion." The FTC's involvement would likely reduce litigation by uncovering improper practices earlier than under the notoriously inept state "market conduct" review systems. This would allow insurers to correct problems sooner, reducing their financial exposure to litigation at a later date.

5. Repeal of the McCarran Ferguson Act coupled with the application of federal antitrust laws would constitute "dual" federal/ state regulation of insurance. Regulation of the business of insurance would remain firmly vested with the states, given that S.618 does not alter the first section of the McCarran-Ferguson Act that delegates the insurance regulation to the states. S. 618 would only empower the FTC and DOJ to help consumers and make sure that antitrust law is not violated. Moreover, state regulators would be in complete control of whether or not federal antitrust intervention in the insurance marketplace occurs. If states do their jobs and implement "active" regulation, as required under the state action doctrine, there would be no need for federal intervention. The problem with state insurance regulation under the McCarran Ferguson Act is, of course, that any form of regulation, no matter how weak, is acceptable. Unfortunately, for consumers, a number of states have decided that virtually no regulation constitutes an acceptable regulatory regime.

6. Repeal of McCarran Ferguson should only occur in conjunction with federal enactment of an "optional federal charter" (OFC) for insurers. There are several reasons why this is unnecessary and even dangerous to consumers. First, the OFC bills that some insurers have supported would sharply reduce consumer protections at a time when experience with insurance claims in the wake of Hurricane Katrina shows that consumer protections need to be enhanced. For instance, under these bills, the federal regulator would have little or no authority to review skyrocketing insurance rates on the coasts or the introduction of anti-consumer contract provisions, such as the anti-concurrent-causation clause. Congress should not reward insurers with their "wish list" of inadequate regulatory controls at any time, particularly when concerns have arisen about insurance industry practices after Hurricane Katrina.

Second, OFC legislation sets up a system of regulatory arbitrage where insurers have the option of selecting the regulator of their choice -- state or federal. Regulators would have to "compete" to bring insurers into their system by lowering consumer protections even further. In contrast, enacting S. 618 alone will require states to enhance their regulatory efforts and improve consumer protections to meet state action doctrine. Third, including an OFC proposal as part of S. 618 would help undermine the positive consumer impact of the bill and create vigorous opposition from consumer organizations, editorial writers and others. Fourth, the anti-trust exemption was always intended by the drafters to be a stand-alone provision and, indeed, as the legislative history shows, was intended to end in about 1946.

CONCLUSION

Congress should end the long history of insurance industry collusion and anticompetitive behavior. This behavior routinely costs consumers more money than a competitive market would because insurers can cooperate in price setting. The business cycle of the property/casualty insurance industry is exacerbated by the availability of pure premium and other rate guides the rate bureaus publish. Many insurers do not use these guides during the "soft" market periods but become a kind of safe harbor when the periodic hard market strikes the commercial property/casualty market. The Katrina experience and the Spitzer revelations show us that collusive insurer behavior has terrible consequences for all buyers, from low-income coastal residents seeking fair claim settlements up to the most sophisticated Fortune 500 corporations seeking reasonably priced insurance.

Public and media support for ending this antitrust exemption has been quite strong for a very long time. Over the decades:

- *Business Week* editorialized that "The Insurance Cartel is Ripe for Busting."[32]
- *The Journal of Commerce* called for an "End to McCarran Ferguson."[33]
- *The New York Times* asked Congress to "Bust the Insurance Cartel."[34]

[32] April 11, 1988.
[33] May 25, 1988.
[34] May 4, 1991.

- *The Los Angeles Times* wanted Congress to take "New Action on an Old Proposal to End Cartel-Like Conditions."[35]

- When the House Judiciary Committee last studied eliminating or scaling back the antitrust exemption, there was much support. Consumer groups, small business groups, AARP, the American Bar Association, the American Bankers Association, labor unions, medical groups and others supported the effort. The American Insurance Association participated in lengthy discussions with the Committee staff and consumer advocates to try to determine a way to cut back the exemption.

- Every independent study of the McCarran-Ferguson Act's antitrust exemption has concluded that it should end.

It is time to heed the advice of federal studies, consumers, and editorial writers and to repeal the antitrust exemption of the McCarran-Ferguson Act. It is time to pass S. 618.

[35] June 12, 1991.

ATTACHMENT A

COLLUSIVE ACTIVITY BY THE INSURANCE SERVICES ORGANIZATION THAT IS ALLOWED BY THE MCCARRAN-FERGUSON ANTITRUST EXEMPTION

The ISO website has had extensive information on the range of services they offer insurance companies. The website illustrates the deep involvement that this organization has in helping to set insurer rates, establishing policy forms, underwriting policies and in setting other rules.

Some examples:

- The page "The State Filing Handbook," promises 24/7 access to "procedures for adopting or modifying ISO's filings as the basis for your own rates, rules and forms."

- The page "ISO MarketWatch Cube" is a "powerful new tool for analyzing renewal price changes in the major commercial lines of insurance...the only source of insurance premium-change information based on a large number of actual policies." This price information is available "in various levels of detail – major coverage, state, county and class groupings – for specific time periods, either month or quarter..."

- "MarketWatch" supplies reports "that measure the change in voluntary-market premiums (adjusted for exposure changes) for policies renewed by the same insurer group...a valuable tool for...strategically planning business expansion, supporting your underwriting and actuarial functions..."

- "ISO's Actuarial Service" gives an insurer "timely, accurate information on such topics as loss and premium trend, risk classifications, loss development, increased limits factors, catastrophe and excess loss, and expenses." Explaining trend, ISO points out that the insurer can "estimate future costs using ISO's analyses of how inflation and other factors affect cost levels and whether claim frequency is rising or falling." Explaining "expenses" ISO lets an insurer "compare your underwriting expenses against aggregate results to gauge your productivity and efficiency relative to the average..." NOTE: These items, predicting the future for cost movement and supplying data on expenses sufficient for turning ISO's loss cost filings into final rates, are particularly anti-competitive and likely, absent McCarran-Ferguson antitrust exemption protection, illegal.

- "ISO's Actuarial Services" web page goes on to state that insurers using these services will get minutes and agendas of "ISO's line actuarial panels to help you keep abreast of ratemaking research and product development."

- The "Guide to ISO Products and Services" is a long list of ways ISO can assist insurers with rating, underwriting, policy forms, manuals, rate quotes, statistics, actuarial help, loss reserves, policy writing, catastrophe pricing, information on specific locations for property insurance pricing, claims handling, information on homeowner claims, credit scoring, making filings for rates, rules and policy forms with the states and other services.

Finally, ISO has a page describing "Advisory Prospective Loss Costs," which lays out the massive manipulations ISO makes to the historic data. A lengthy excerpt follows:

> "Advisory Prospective Loss Costs are accurate projections of average future claim costs and loss-adjustment expenses — overall and by coverage, class, territory, and other categories.
> Your company can use ISO's estimates of future loss costs in making independent decisions about the prices you charge for your policies. For most property/casualty insurers, in most lines of business, ISO loss costs are an essential piece of information. You can consider our loss data — together with other information and your own judgment — in determining your competitive pricing strategies.
>
> "**The insurance pricing problem** –Unlike companies in other industries, you as a property/casualty insurer don't know the ultimate cost of the product you sell — the insurance policy — at the time of sale. At that time, losses under the policy have not yet occurred. It may take months or years after the policy expires before you learn about, settle, and pay all the claims. Firms in other industries can base their prices largely on known or controllable costs. For example, manufacturing companies know at the time of sale how much they have spent on labor, raw materials, equipment, transportation, and other goods and services. But your company has to *predict* the major part of your costs — losses and related expenses — based on historical data gathered from policies written in the past and from claims paid or incurred on those policies. As in all forms of statistical analysis, a large and consistent sample allows more accurate predictions than a smaller sample. That's where ISO comes in. The ISO database of insurance premium and loss data is the world's largest collection of that information. And ISO quality checks the data to make sure it's valid, reliable, and accurate. But before we can use the data for estimating future loss costs, ISO must make a number of adjustments, including loss development, loss-adjustment expenses, and trend.
>
> "**Loss development ...**because it takes time to learn about, settle, and pay claims, the most recent data is always incomplete. Therefore, ISO uses a process called *loss development* to adjust insurers' early estimates of losses to their ultimate level. We look at historical patterns of the changes in loss estimates from an early evaluation date — shortly after the end of a given policy or accident year — to the time, several or many years later, when the insurers have settled and paid all the losses. ISO calculates *loss development factors* that allow us to adjust the data from a number of recent policy or accident years to the ultimate settlement level. We use the adjusted — or developed — data as the basis for the rest of our calculations.
>
> "**Loss-adjustment expenses –** In addition to paying claims, your company must also pay a variety of expenses related to settling the claims. Those include legal-defense costs, the cost of operating a claims department, and others. Your company allocates some of those costs — mainly legal defense — to particular claims. Other costs appear as overhead. ISO collects data on allocated and unallocated loss-adjustment expenses, and we adjust the claim costs to reflect those expenses.

"Trend –Losses adjusted by loss-development factors and loaded to include loss-adjustment expenses give the best estimates of the costs insurers will ultimately pay for past policies. But you need estimates of losses in the future — when your new policies will be in effect. To produce those estimates, ISO looks separately at two components of the loss cost — claim *frequency* and claim *severity*. We examine recent historical patterns in the number of claims per unit of exposure (the frequency) and in the average cost per claim (the severity). We also consider changes in external conditions. For example, for auto insurance, we look at changes in speed limits, road conditions, traffic density, gasoline prices, the extent of driver education, and patterns of drunk driving. For just three lines of insurance — commercial auto, personal auto, and homeowners — ISO performs 3,000 separate reviews per year to estimate loss trends. Through this kind of analysis, we develop *trend factors* that we use to adjust the developed losses and loss-adjustment expenses to the future period for which you need cost information.

"What you get – With ISO's advisory prospective loss costs, you get solid data that you can use in determining your prices by coverage, state, territory, class, policy limit, deductible, and many other categories. You get estimates based on the largest, most credible set of insurance statistics in the world. And you get the benefit of ISO's renowned team of actuaries and other insurance professionals. ISO has a staff of more than 200 actuarial personnel — including about 50 members of the Casualty Actuarial Society. And no organization anywhere has more experience and expertise in collecting and managing data and estimating future losses."

ISO's activities extensively interfere with the competitive market, a situation allowed by the provisions of the McCarran-Ferguson Act's extensive antitrust exemption.

2004 EXPENSE RATIOS

ATTACHMENT B

LINE	AVG. FOR ALL INSURANCE COS.			AN EFFICIENT WRITER WITH AT LEAST 1% OF NATIONAL MARKET			AN INEFFICIENT WRITER WITH AT LEAST 1% OF NATIONAL MARKET			POTENTIAL RATE SAVINGS*	
	LOSS ADJUST-MENT	UNDER-WRITING	TOTAL	LOSS ADJUST-MENT	UNDER-WRITING	TOTAL	LOSS ADJUST-MENT	UNDER-WRITING	TOTAL	IF AVERAGE BECAME EFFICIENT	IF INEFFICIENT BECAME EFFICIENT
Fire	5.1%	26.0%	31.1%	0.9%	18.8%	19.6%	5.0%	56.4%	61.4%	-14.3%	-52.0%
Allied	6.3%	31.2%	37.5%	1.9%	21.1%	23.0%	6.6%	49.2%	55.8%	-18.8%	-42.6%
Farmowners	7.2%	31.6%	38.8%	4.4%	15.8%	20.2%	4.1%	63.9%	68.0%	-23.3%	-59.9%
Homeowners	9.9%	28.4%	38.3%	10.8%	19.6%	30.4%	5.6%	41.9%	47.5%	-11.4%	-24.6%
CMP non-liab	9.6%	32.7%	42.3%	3.5%	10.2%	13.7%	7.7%	41.4%	49.1%	-33.1%	-41.0%
CMP liability	25.5%	31.5%	57.0%	5.5%	17.7%	23.2%	41.9%	33.5%	75.4%	-44.0%	-68.0%
Inland Marine	7.0%	32.5%	39.5%	2.2%	22.5%	24.7%	52.8%	33.3%	86.1%	-19.7%	-81.5%
Med Mal	34.0%	15.2%	49.2%	19.4%	22.4%	41.8%	57.6%	12.4%	70.0%	-12.7%	-48.5%
Work Comp	13.5%	21.5%	35.0%	10.6%	15.2%	25.8%	26.4%	18.1%	44.5%	-12.4%	-25.2%
Other Liab	23.5%	27.1%	50.6%	5.5%	25.8%	31.3%	53.8%	26.1%	79.9%	-28.1%	-70.7%
PP Auto Liab	14.0%	23.1%	37.1%	10.8%	12.9%	23.7%	17.5%	26.6%	44.1%	-17.6%	-26.7%
CC Auto Liab	12.7%	28.0%	40.7%	11.3%	20.2%	31.5%	15.8%	32.7%	48.5%	-13.4%	-24.8%
PP Auto Phys	9.8%	23.4%	33.2%	9.4%	12.8%	22.2%	13.6%	26.8%	40.4%	-14.1%	-23.4%
CC Auto Phys	7.1%	28.4%	35.5%	7.4%	19.5%	26.9%	4.4%	41.0%	45.4%	-11.8%	-25.3%
							AVERAGE SAVINGS			-19.6%	-43.9%
All Lines	12.9%	25.4%	38.3%	11.8%	15.0%	26.8%	17.8%	30.9%	48.7%	-15.7%	-29.9%

Source: A.M. Best and Co., Aggregates and Averages, 2005 Edition

* Calculated as follows: (1.000 - expense ratio of inefficient writer/ 1.000 - expense ratio of efficient writer) - 1.000

Attachment C: Reprinted from The Los Angeles Times, November 28, 2006

Insurance company cutbacks have left more than 1 million coastal residents scrambling to land new insurers or learning to live with weakened policies. As insurers retreat, states and homeowners are left to bear the biggest risks.

Massachusetts

During the last two years, six insurers have stopped selling or renewing policies along the coast, especially on Cape Cod, leaving 45,000 homeowners to look for coverage elsewhere. Most have turned to the state-created insurer of last resort. The Massachusetts FAIR Plan, now the state's largest homeowners insurer, recently received permission to raise rates 12.4 percent.

Connecticut

Atty. Gen. Richard Blumenthal has subpoenaed nine insurance companies to explain why they are requiring thousands of policyholders whose houses are near any water —coast, river or lake —to install storm shutters within 45 days or have their coverage cut or canceled.

New York

Allstate has refused to renew 30,000 policies in New York City and Long Island, and suggested it may make further cuts. Other insurers, including Nationwide and MetLife, have raised to as much as 5 percent of a home's value the amount policyholders must pay before insurance kicks in, or say they will write no new policies in coastal areas.

South Carolina

Agents say most insurers have stopped selling hurricane coverage along the coast. Those that still do have raised their rates by as much as 100 percent. The state-created fallback insurer is expected to more than double its business from 21,000 policies last year to more than 50,000.

Florida

Allstate has offloaded 120,000 homeowners to a start-up insurer and has said it will drop more as policies come up for renewal. State-created Citizens Property, now the state's largest homeowners insurer with 1.2 million policies, was forced to use tax dollars and issue bonds to plug a $1.6- billion financial hole due to hurricane claims. The second-largest, Poe Financial Group, went bankrupt this summer, leaving 300,000 to find coverage elsewhere. The state also has separate funds to sell insurers below-market reinsurance and cover businesses. Controversy over insurance was a major issue in this fall's election campaign, causing fissures in the dominant GOP.

Louisiana

The state's largest residential insurer, State Farm, will no longer offer wind and hail coverage as part of homeowners policies in southern Louisiana. In areas where it still covers these dangers, it will require homeowners to pay up to 5 percent of losses themselves before insurance kicks in. In a move state regulators call illegal and are fighting, Allstate is seeking to transfer wind and hail coverage for 30,000 of its existing customers to the state created Citizens Insurance.

Texas

Allstate and five smaller insurers have canceled hurricane coverage for about 100,000 homeowners and have said they will write no new policies in coastal areas. Texas' largest insurer, State Farm, is seeking to raise its rates by more than 50 percent along the coast and 20 percent statewide.

California

The state has bucked the trend toward higher homeowners insurance rates with three major insurers, State Farm, Hartford and USAA, seeking rate reductions of 11 percent to 22 percent. Regulators have begun to question whether insurers are making excessive profits after finding that major companies spent only 41 cents of every premium dollar paying claims and related expenses. Alone among major firms, Allstate is seeking a 12.2 percent rate hike.

Washington

Allstate has dropped earthquake coverage for about 40,000 customers and will have its agents offer the quake insurance of another company when selling homeowners policies in the state. Nationally, the company has canceled quake coverage for more than 400,000.

Sources: Risk Management Solutions (map); interviews with state insurance regulators

NOTE: Since the Los Angeles Times ran this recap of actions on the coasts, Allstate has announced it will stop writing new homeowner's insurance policies in many areas near the coast, including the entire state of Connecticut, the entire state of Delaware, and large portions of Maryland and Virginia. Allstate has begun to non renew policies in Louisiana. In California, several additional insurers have announced that they will be reducing rates. Regulators have begun to question whether insurers are making excessive profits after finding that major carriers have spent only 41 cents of every premium dollar paying claims and related expenses. Alone among major companies, Allstate is seeking a 12.2 percent rate hike, although the state insurance commissioner has suggested that the company may be required to lower rates and issue refunds for past overcharges instead. Regulators in California have more authority to question rates than in other states under Proposition 103, the voter-approved regulation system.

Independent Insurance Agents
& Brokers of America, Inc.

STATEMENT OF THE
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA
BEFORE THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
HEARING ON

"The McCarran-Ferguson Act and Antitrust Immunity:
Good for Consumers?"

March 7, 2007

Chairman Leahy and Ranking Member Specter, the Independent Insurance Agents & Brokers of America (IIABA) appreciates the opportunity to present our association's perspective on the McCarran-Ferguson Act's limited federal antitrust exemption for the regulated business of insurance.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, and we represent a nationwide network of more than 300,000 agents, brokers, and their employees. Independent insurance agents and brokers present consumers with a choice of policy options from a variety of different insurance companies. These small, medium, and large businesses offer all lines of insurance – property, casualty, life, health, employee benefit plans, and retirement products.

Our members have a strong interest in the subject of today's hearing. We are concerned that repeal of the McCarran-Ferguson's limited federal antitrust exemption for the business of insurance would have a direct negative impact on insurance consumers, independent agents, and small and medium sized insurers in the marketplace. We believe that the qualified application of federal antitrust law to this sector has served both the market and consumers well, and there is little evidence indicating that wholesale changes to the McCarran-Ferguson antitrust exemption are needed or even desirable.

Limited Scope of the Present Exemption

The McCarran-Ferguson Act provides a limited exemption not to insurers or any particular entities, but rather to the "business of insurance" from the federal antitrust laws. The entities in the industry are not exempt for conduct that is not part of that core activity. Moreover, the Act provides that the Sherman Act, the Clayton Act, and the Federal Trade Commission Act only apply to the business of insurance "to the extent that such business is not regulated by state law." Therefore, the McCarran-Ferguson Act only exempts from the federal antitrust laws, insurance activity which is regulated or supervised by state authorities, including being subject to state antitrust scrutiny. Further, even that limited exemption from federal antitrust law does not extend to "any agreement to boycott, coerce or intimidate, or act of boycott, coercion, or intimidation," which remain subject to the Sherman Act.

The Act also declares that the business of insurance shall be subject to regulation and taxation by the states. After passage of the Act in 1945, virtually all states adopted or retained some form of rate (and form) regulation to qualify for the exemption. The practical import of the antitrust exemption has, to some extent, been eroded over the decades as courts have narrowed the definition of the "business of insurance" and broadened the definition of "boycott," and as an increasing number of states have expressly subjected the insurance industry to state antitrust law.

Litigation regarding the scope of the federal antitrust exemption has focused on the meaning of the terms "business of insurance" and "regulated by state law," and the question of what constitutes a "boycott." Supreme Court decisions regarding the scope of the phrase "the business of insurance" focus on three elements: the "spreading and underwriting of a policyholder's risk," the direct connection of the activity to the contractual relationship between the insurer and insured, and whether the allegedly anticompetitive practice is "limited to entities within the insurance industry." Regulation by the state has been held to mean regulation of the relationship between the insurance company and the policyholder, and not regulation of other aspects of the insurer's business.

The business of insurance is not unique in having a qualified exemption from full application of the federal antitrust laws, but it is perhaps unique among those industries in having a comprehensive state-level system of regulation and antitrust enforcement. In fact, state regulatory oversight, supplemented by state and federal law enforcement has produced vibrant competition in the marketplace. In nearly every aspect of the insurance marketplace and certainly in main street America, the existence of effective competition serves as a check and a balance to the abuses that sometimes attend industry consolidation. While there are certainly imperfections in insurance markets, including affordability and/or availability in some lines, there is little evidence or reason to believe that the problems and challenges confronting the industry would be lessened or improved by a wholesale change to the McCarran-Ferguson Act antitrust exemption.

Effect of Repeal

IIABA believes that the McCarran-Ferguson's limited federal antitrust exemption promotes competition in the insurance marketplace and is entirely consistent with the purposes of antitrust law. S. 618, the "Insurance Industry Competition Act," which was introduced recently in the Senate, would abrogate protections afforded by the McCarran-Ferguson Act. It would expand federal antitrust regulation in the insurance market at the expense of competition and consumer protections. We believe that a complete repeal of the limited McCarran-Ferguson antitrust exemption would introduce uncertainty into the insurance market about the continued use of certain pro-competitive practices, and thus would likely reduce competition, increase the cost of insurance and reduce the availability for some high-risk coverages.

Any consideration of McCarran-Ferguson Act antitrust exemption repeal should consider the general structure and competitive state of the insurance sector. The insurance marketplace is highly competitive, and both personal and business consumers are generally well-served as a result. Insurance buyers have an array of options when they buy insurance. We see little need for making wholesale changes to the antitrust system that would severely disrupt this competitive marketplace.

The independent agency system plays an especially important role in the marketplace. Unlike other distribution channels, agencies maintain relationships with multiple insurers and can offer more choice to customers (on average, agencies offer policies from eight personal lines carriers and seven commercial lines carriers). As a distribution channel for competing insurance companies, our members are uniquely qualified to attest to the level of competition in the insurance marketplace.

Independent insurance agents and brokers invest substantial effort to identify consumers' wants and needs, understand the complex terms of policies available, assess the products available and present choices to the consumer about coverage, price, service, and financial strength of carriers. We remain available to assist with any questions and changes as needed. Independent agents are not locked into one company's policies or products; since they can access multiple companies, they can help consumers locate coverage that is tailored to fit specific needs and desires.

Independent agents who sell both commercial and personal lines insurance are in a position to witness the effects of this intense competition in the marketplace every day. If an insurance provider ultimately offers a buyer insurance terms that are below par, prices that are inexplicably higher than others, or service that does not create a value proposition for the purchaser, that buyer will move its business elsewhere.

S.618 Would Harm Competition in the Insurance Marketplace and Create Redundant Federal Regulation

McCarran-Ferguson has made possible certain collective activities that, when engaged in under active state supervision, have had a beneficial effect on competition and consumer protection. At its base, insurance is about the business of assuming and spreading risk. The sharing of claims data permitted by McCarran-Ferguson increases access to information and allows the accurate pricing of risk. It thereby tends to reduce the price of insurance.

Limited collective action is important for loss forecasting. Currently, insurance consumers have an array of options when they buy insurance, but this legislation could severely disrupt this competitive marketplace. Smaller companies rely on the pooling of data that is possible because of McCarran-Ferguson to properly measure and price risk. Large national companies often have sufficient claims experience to price risk more accurately based on their own internal data (although even these insurers can compete in niche markets outside their core business only by using pooled data). Repeal of the McCarran-Ferguson antitrust exemption would give larger insurers a competitive advantage over their smaller competitors. The inability to pool data would disproportionately affect small to medium sized companies (or niche competitors) who may be forced to limit the lines that they are willing to underwrite, and would almost certainly diminish the vibrant competition that currently exists.

We therefore believe that a total repeal would not only negatively affect the livelihood of our members, but it also would have a disparate impact on small and medium size insurance companies who would be unable to compete effectively in the marketplace. Again, we are concerned that repeal might actually reduce competition, increase costs, and reduce availability, because the threat of antitrust litigation could make insurers unwilling to engage in efficiency-enhancing cooperative activities.

McCarran-Ferguson also has permitted the development (again, under the vigilant eye of state regulators) of standardized policy forms. This has greatly benefited consumers, by permitting "apples to apples" comparison of material terms of coverage.

IIABA is also concerned that the Insurance Industry Competition Act would lead to unnecessary dual federal and state regulation by granting the Federal Trade Commission additional oversight and power to investigate the insurance market. Insurance companies are subject to state antitrust laws and, where not regulated by the state, federal antitrust laws. The insurance market is already heavily-regulated at the state level, and subjecting the market to additional oversight from the federal government would create more problems than it solves.

Need for Pro-Competitive Safe Harbors

IIABA does not believe that the McCarran-Ferguson antitrust exemption should be modified. However, if it is modified, certain functions, such as the standardization of policy forms and the collection of historical loss data, that are pro-consumer and pro-competitive, at a minimum, should continue to be protected under federal law and not subjected to federal antitrust challenge.

Standardization of Forms

Cooperation on the design of policy forms is pro-competitive because it facilitates comparison shopping by insurance consumers. Without common forms, policy language would vary significantly between policies, and consumers would suffer as they would lose the ability to compare common policies. Without standardized forms, consumers would be left with the challenge of trying to compare and contrast policies, which would lead to, at best, consumer frustration and confusion, and, at worst, a loss of coverage and unpaid losses. Additionally, without a safe harbor for standardized forms, it will be difficult for agents to interpret and explain differences in policies to consumers.

Collection of Historical Loss Data

The information gains from data pooling are greatest for small insurers. Even large insurers benefit from data pooling in unpredictable lines, particularly in states and lines where their own experience is relatively thin. By using loss costs as a benchmark, insurers can satisfy those demands at reasonable risk even in states or lines where they do not have a large market share. All of this is pro-competitive. Some risk sharing through risk pools also generally increases the availability of coverage. Congress should take care not to destroy these pro-competitive benefits.

Conclusion

IIABA understands the concerns voiced by supporters of this legislation, but we believe that a repeal of the McCarran-Ferguson antitrust exemption would disrupt the insurance marketplace and result in more harm than good. The insurance marketplace is actively regulated by state insurance commissioners. We believe that the solvency of the industry and the intense state of competition and the abundance of consumer choice in the insurance marketplace attest to the success of this system. A vibrant system of direct state supervision/law enforcement supplemented by a limited application of federal antirust enforcement has served the industry and the consuming public well. We see little reason or evidence for making wholesale changes to the antitrust regulations that apply to the insurance sector.

While we have concerns about any modifications to the McCarran-Ferguson Act antitrust exemption, we believe that, at a minimum, the long-standing joint practices of the sharing of historical claims data (but not final prices) and the joint development of standardized policy forms must be protected. We also are opposed to the dual federal and state oversight that this legislation would create. Overall, though, we urge you to consider all of the ramifications of this proposal for the nation's insurance consumers, independent agents, and small insurance companies, before moving to full consideration of a repeal of this qualified exemption.

Senator Kennedy Statement on

McCarran-Ferguson Act and Antitrust Immunity

I thank the Chairman for convening today's hearing. I've long been concerned that the antitrust exemption for insurance companies contained in the McCarran-Ferguson Act leaves consumers vulnerable to monopoly behavior that deprives them of protection against loss when they most need it. In the wake of Hurricanes Katrina and Rita, the industry has terminated the policies of hundreds of homeowners in Louisiana, refused to write new policies for Mississippi homeowners, and raised premiums throughout the region. Obviously, the current exemption from federal antitrust regulation does not protect consumers.

We considered modifying this exemption after the liability insurance crisis in the 1980s. At the time, consumers faced premium rate increases of several hundred percent. Some types of coverage were unavailable, and the cost of automobile insurance rose dramatically. Nineteen state attorneys general filed suit challenging the industry's increased rates and industry-wide attempts to rewrite standard insurance contracts. Many of us supported the Insurance Competition Improvement Act of 1989, but it failed to pass. It would have protected consumers by supporting State regulation of the insurance industry and promoting free competition in the industry by modifying the exemption in the McCarran-Ferguson Act.

We also attempted to protect patients by modifying the exemption to prevent monopolistic behavior by insurance companies that offer policies on medical malpractice. In 2003 and in 2005, I supported Senator Leahy's Medical Malpractice Insurance Antitrust Act, which would have prevented the price-fixing, bid-rigging, and other unacceptable practices which the broad insurance exemption allows in medical malpractice insurance, and which caused grossly inflated premiums and rising health care costs for patients.

Today, more than a year after Hurricanes Katrina and Rita, thousands of citizens are returning to the Gulf area to rebuild their lives and homes. Yet they are being denied property insurance, which is required by federal law to obtain a loan to rebuild. Continuing to allow the insurance industry to operate under the protection of the antitrust exemption will prevent thousands of these people from returning to their homes. We owe it to the citizens of the Gulf area to protect them from insurance companies that are too large to be regulated effectively by individual states, yet are exempt from federal regulation.

Since Hurricane Katrina, low-risk areas such as northern Louisiana have seen a decrease in homeowner insurance rates, while areas such as Orleans Parish and Jefferson Parish have seen an average rate increase of 52 percent. The Louisiana Department of Insurance has received 386 claims from homeowners that Allstate Insurance Company alone has refused to renew their policies without proper inspections to determine whether the homes were occupied or under construction. These cancellations took place despite a Louisiana law that bars insurers from canceling policies that have been in effect for at least three years. Following the reopening of a class action settlement that may lead to larger damage awards, State Farm Insurance has announced that it will not write any new homeowner policies in Mississippi.

The contention that it is too risky to insure Gulf Coast property against storms that are likely to occur regularly is an after-the-fact excuse for denying coverage. According to the Insurance Information Institute, catastrophic events like hurricanes cost insurers a combined $62 billion in 2005, but only $8.8 billion in 2006. Storms like Katrina and Rita do not occur every year, but enabling customers to hedge against possible future damage to their property is precisely the business of insurance companies. As companies with a national consumer base, and a national demand for their valuable services, insurance companies should not be allowed to raise premiums excessively or bar access to insurance for certain groups of people because of an outdated law that arbitrarily exempts them from federal antitrust regulation.

I hope that this hearing will be the start of reform in this important area.

Testimony of Senator Mary L. Landrieu
Before the Senate Judiciary Committee Hearing
On the Insurance Industry's Anti-Trust Exemption
March 7, 2007

Mr. Chairman and members of the committee, thank you for inviting me testify about the insurance crisis we are facing in the Gulf in the aftermath of Hurricanes Katrina and Rita. I also must welcome my constituent Michael Homan from New Orleans and look forward to his testimony today. His experience trying to get a satisfactory claim payment from Allstate is one that thousands of Louisiana property owners have faced. He will put a human face on this crisis.

I referred to the insurance situation in the Gulf as a "crisis" not to be overly dramatic, but to convey to this committee the deep threat the current insurance environment poses to the successful recovery from those two devastating storms. This insurance crisis has played out in stages since Katrina and the ensuing destruction of the levees in New Orleans 18 months ago. The first stage of the crisis happened in the early months after the storm when home and business owners learned that their property insurance would cover wind damage from the storm, but would not cover damage caused by the storm surge or the rising waters after the levees broke. You needed a policy through the National Flood Insurance Program (the "NFIP"), or you were out of luck.

The "Wind vs. Water" issue spawned thousands of lawsuits like Dr. Homan's. His case and many others have not settled. I don't believe that when these homeowners paid their premiums they never imagined that they would have to sue to get their claims paid.

The second stage of the crisis is happening all over Louisiana and the Gulf today. Insurance premiums have skyrocketed. According the Louisiana Department of Insurance, rates have increased statewide by 13.2 percent. But in New Orleans and Jefferson Parish, rates have gone up for some carriers as much as 50 percent or greater. I have even heard of one company that raised its premiums by 145 percent. Many insurance companies are not renewing policies in the region, or refusing to write new policies. Companies are also increasing deductibles to levels that are too expensive for policy holders.

All of this means that if they can afford insurance, people will end up getting less coverage and paying more for it. A recent Times Picayune article described the experience of Ralph Godwin, President of RCG Longview Realty Services. He bought an apartment building in August of 2006 that had an existing insurance policy on it from before Katrina with premiums of $400 per unit. The policy included full wind and flood coverage. When he went to renew the policy, the premium increased to $1,265 per unit with higher deductibles, lower coverage for wind, and exclusions for flood. Ralph Godwin is a major developer in New Orleans and owns a number of properties. While he may have the means to pay higher premiums, in most instances that will be passed to my constituents in the form of higher rents. This has already happened in New Orleans. Rent for a two bedroom apartment increased nearly 40 percent on average from before the storm in 2005 to 2006.

Mr. Chairman, this new stage of the insurance crisis threatens the economic recovery of the entire region. The people of Louisiana, our state, and local governments are working hard to rebuild our communities. The state enacted new building codes so that new construction will have a better chance withstanding a storm. The Federal government has provided substantial resources to the recovery effort: $10.5 billion in Community Development Block Grant funding to help people rebuild their homes and the infrastructure; $1.1 billion in tax credits to build affordable housing; and $6 billion in tax incentives on top of this to encourage investment in plant and equipment by our businesses.

But if people cannot afford insurance, there will be no recovery. A business owner is not going to rebuild a warehouse or a manufacturing facility if they cannot afford insurance. If a homeowner cannot afford their insurance, they are not going to rebuild their homes; they will take their money and their families and go elsewhere.

The insurance crisis threatens the federal investment in the region. The Gulf Opportunity Zone (GO Zone) Act of 2005 increased the state's allocation of low income housing tax credits to build affordable housing in the Gulf. The Louisiana Housing Finance Agency has allocated more than $183 million in these credits to 240 different housing projects and programs. But according to the Times Picayune a number of these projects are at a standstill because insurance and construction costs are so high. These developers will lose these credits if they do not have their buildings in service by

December of 2008. That investment in affordable housing will be lost in part because of insurance costs.

Mr. Chairman the time has come for the Federal government to reconsider the hands-off approach it has taken to insurance regulation, particularly in the face of the disruption in the market since Katrina and Rita. Certainly, we are going to see other hurricanes in the Gulf, so the potential for another round of large catastrophic storms exists. But other parts of the country have their own risks: earthquakes in California for example; potential tsunamis in the Pacific Northwest. I have no doubt that in the event of a catastrophe in these areas of the country, the same insurance market failure will occur.

It is the proper role of the Federal government to step in and regulate where markets have failed. We did it after 9-11 when insurance companies could not get reinsurance for terrorist acts. To address this market failure we passed the Terrorism Risk Insurance Act (TRIA) to set up a federal reinsurance backstop.

Mr. Chairman, I joined you as a cosponsor of S. 618, the Insurance Industry Competition Act of 2007, in order to begin the dialog for how we address the insurance crisis in the Gulf and to prevent these kinds of market failures in future disasters. The bill would eliminate the antitrust exemption the insurance industry has enjoyed since passage of the McCarran-Ferguson Act of 1945. Insurance companies engage in a lot of practices that if done by any other business in this country would violate the antitrust laws. Insurance companies are allowed to share loss data, use common risk classifications, and standardized forms. The industry relies on insurance service organizations (ISOs) to establish loss trend data which insurers than use to set rates. The Government Accountability Office (GAO) found in 2005 that these kinds of activities might violate the antitrust laws depending upon the facts and circumstances of the case.

Will repeal of McCarran-Ferguson solve the problems we face in the Gulf? I am not sure that I know the answer to that question. But if it takes the threat of repeal to get the Congress, the states, and the industry to sit down and discuss a solution, I am all for it. We should also consider other proposals and solutions to the problem. To this end, I am a cosponsor of Senator Bill Nelson's legislation, S. 292, the Commission on Catastrophic Risk and Insurance Act of 2007, to create a bipartisan commission to study a range of options and make recommendations to the Congress about how we fix the problems in the Gulf.

I certainly think that this special commission should take a look at the antitrust exemption under McCarran as a part of its larger examination of the industry, but there have been a number of other proposals put forward to address the insurance crisis. There are tax ideas such as allowing insurance companies to retain their reserves tax free or tax-free disaster savings accounts. Legislation has been introduced to establish a federal reinsurance pool or to set up another backstop similar to TRIA. Other members have proposed all perils insurance as part of the National Flood Insurance Program.

Mr. Chairman, I realize this hearing today is only a first step, but an important one. I hope that it will serve as a beginning for a more thorough examination of the insurance crisis in the Gulf. Thank you again for giving me the opportunity to testify.

Trent Lott

United States Senate
Committee on the Judiciary

The McCarran-Ferguson Act and Antitrust Immunity:
Good for Consumers?

March 7, 2007

Statement of
United States Senator Trent Lott

Let me begin by thanking Chairman Leahy and Senator Specter, the Ranking Member, for all of their efforts on this issue. I am thankful for this opportunity to address the Committee on this issue that I believe is vitally important to my constituents.

As I have stated before, it wasn't until after Hurricane Katrina that I gained a true understanding of the fact that the insurance industry had a ~~blanket~~ exemption from our antitrust laws. And as I witnessed the reprehensible behavior of the insurance industry in their response to Katrina, I became curious about the history, rationale, and wisdom of such a broad exemption from federal oversight.

As I began to research the history of the exemption, I was astounded by what I found. Until 1944, regulation of the business of insurance resided securely with the States, based on the rationale that this business did not meet the legal definition of "interstate commerce." That year, the insurance industry was turned on its head by the Supreme Court in the case of *United States v. South-Eastern Underwriters Association*. By signaling that the business of insurance <u>is</u> "interstate commerce," the case brought about a knee-jerk reaction from Congress in a bill that would eventually be known as the McCarran-Ferguson Act.

Soon after the Supreme Court decision, Senators McCarran and Ferguson introduced a bill that within two weeks, and without any hearings, passed the Senate. The House also passed a similar measure with little debate. A review of the Congressional Record shows clearly that the intent of both houses was to provide only a temporary moratorium rather than the permanent exemption.

It was while the bill was being discussed by the conference committee that a seemingly innocuous phrase was inserted. It was this modification – not in either the House or Senate versions of the bill – that when judicially interpreted turned a temporary moratorium into a permanent exemption.

The House approved the conference report without debate. The Senate, in contrast, debated the conference report for two days. Again, the record of the debate clearly shows that a permanent exemption was not the intent of those who voted for its passage. So clear was this intent, that President Roosevelt, upon signing the bill, stated the following in a press release: "After a moratorium period, the antitrust laws * * * will be applicable in full force and effect to the business of insurance..."

So what happened? The problem resides in the interpretation of the phrase "regulated by state law." Under the McCarran-Ferguson Act, insurers are exempt from federal antitrust scrutiny so long as they are "regulated by state law." Courts have interpreted this phrase to require only that state regulators have jurisdiction over particular conduct—regardless of whether that authority is ever exercised.

In other words, joint conduct by insurance companies would not be subject to antitrust scrutiny unless it was undertaken pursuant to a clearly articulated state policy that is actively supervised by the state. As a result, anticompetitive conduct may escape both regulatory oversight and antitrust scrutiny.

So for more than 6 decades, the insurance industry has operated largely beyond the reach of federal competition laws. I truly believe that the McCarran-Ferguson Act's antitrust exemption has allowed insurers to engage in anticompetitive conduct, and I can find no justification to exempt the insurance industry from federal government oversight. Such oversight could help make certain that the industry is not engaging in anticompetitive conduct such as price fixing, agreements not to pay, and market allocations.

Insurers may object to being subject to the same antitrust laws as everyone else, but if they are operating in an honest and appropriate way, they should have nothing to fear. American consumers and American businesses rely on insurance - it is a vital part of our economy - and they have the right to be confident that the cost of their insurance, and the decisions by their insurance carriers about which claims will be paid, reflect competitive market conditions, not collusive behavior.

The National Association of Mutual Insurance Companies (NAMIC) offers the following comments concerning the limited antitrust exemption provided for the business of insurance under the McCarran-Ferguson Act. Founded in 1895, the National Association of Mutual Insurance Companies (NAMIC) is a full-service national trade association serving the property/casualty insurance industry with more than 1,400 member companies that underwrite more than 40 percent of the property/casualty insurance premiums in the United States. NAMIC members are small farm mutual companies, state and regional insurance companies, risk retention groups, national writers, reinsurance companies, and international insurance giants.

In response to the decision of the United States Supreme Court in *United States v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), that insurance was "interstate commerce" and subject to regulation by the federal government, Congress, in 1945, enacted the McCarran-Ferguson Act (15 USC 1011, *et seq*). The McCarran-Ferguson Act provided for the continued regulation of insurance by the states and provided a narrow exemption from the general federal antitrust laws.[1] Specifically, the exemption is limited to activities that (1) constitute the "business of insurance," (2) are "regulated by State law," and (3) do not constitute "an agreement to boycott, coerce or intimidate or an act of boycott, coercion or intimidation. In addition, like other exemptions from antitrust laws, this exemption is to be construed narrowly.

The Committee is exploring whether the McCarran-Ferguson is good for consumers and the answer is a resounding yes. The application of the McCarran-Ferguson limited federal antitrust exemption has worked well for decades to promote and maintain a healthy, vibrant and competitive insurance marketplace, to serve and protect the nation's policyholders and to ensure the financial integrity of the industry. State regulators and law enforcement officials carefully supervise insurance industry practices, take prompt corrective behavior where warranted and utilize the full force of law in cases of illegal actions. As a result of the McCarran-Ferguson Act consumers enjoy a more competitive marketplace, greater availability and variety of coverage, more accurate pricing, and financial soundness.

There are more than 5,000 insurers operating in the United States, the majority of which are relatively small. A number of studies over the years, including those done by the U.S. Department of Justice, state insurance departments and

[1] The Sherman Act (prohibits restraint of trade and monopolistic practices), the Clayton Act (prohibits anti-competitive practices), the Robinson-Patman Act (an amendment to the Clayton Act prohibits price discrimination among customers who compete against each other), and the Federal Trade Commission Act (prohibits unfair methods of competition and deceptive practices).

respected economists and academics, have consistently concluded that the insurance industry is very competitive under classic economic tests.

The competitiveness and diversity in the insurance market is evidenced by NAMIC's membership in terms of size, geographic dispersion, lines of business and corporate structure. The McCarran-Ferguson exemption has contributed to this diversity and increased the number and competence of insurers by making it easier for small and medium size insurers to compete and enabling the development of specialized and niche markets. The existence of the exemption promotes competition in the insurance marketplace by allowing companies to exchange critical data regarding losses and other factors, facilitating participation and oversight of state guaranty funds, permitting state control over liquidations and enabling the development and operation of assigned risk plans.

Over the past 60 years a substantial body of case law has developed interpreting the narrow limitations. The McCarran-Ferguson limitations apply only to the "business of insurance," which is undefined in the statute. Prior to 1969, the courts generally construed the term to include virtually all activities engaged in by an insurance company; however, the Supreme Court narrowed the provision in *SEC v. National Securities, Inc.,* 393 U.S. 453, 459-60 (1969), distinguishing the "business of insurance" from the "business of insurance companies." In the wake of the *National Securities* decision, the Court developed a three-prong test to decide whether an activity constitutes the "business of insurance": 1) whether the activity transfers or spreads a policyholder's risk; 2) whether it is an integral part of the policy relationship between the insurer and the insured; and 3) whether the activity is limited to entities within the insurance industry. [2] The courts have consistently reaffirmed the essential nature of risk transfer to the "business of insurance."

Similarly, the relationship between the insurer and the policyholder is central to the determination of whether the activity is the "business of insurance." Activities that revolve around the contract of insurance – the type of policy, interpretation, enforcement, etc. – go to the relationship with the insured. State rules and regulations regulating this relationship, whether directly or indirectly, regulate the "business of insurance."

Cases involving the determination of whether activities constitute the "business of insurance" are highly fact-specific. However, reflecting the concern of Congress over the difficulty of underwriting risks in an informed and responsible way without intra-industry cooperation, the courts have generally found that activities facilitating the exchange of information necessary to ratemaking constitute the "business of insurance." Practices not involving ratemaking have been less likely to be construed by the courts as the "business of insurance." The ability of

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[2] *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979) and *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982).

insurers to engage in effective ratemaking activities goes to the heart of risk-sharing inherent in the "business of insurance."

The limited exemptions under the McCarran-Ferguson Act facilitate standardization of risk classification and policy language. Standardized risk classification and policy language make data more credible and enable consumers to better compare offers. Standardization affords consumers greater opportunity to assess competing price and coverage options and reduces litigation over interpretation, streamlining the claims process. Without standardization it would more difficult for consumers to shop for insurance coverage to meet their needs and to effectively shop for price.

The information exchanges permissible under the McCarran-Ferguson Act benefit consumers by increasing the accuracy of pricing. Insurance is fundamentally different from other products, including other financial products, in that insurance is a promise of future financial obligations. As such, insurers lack complete information about the ultimate cost of the product at the time of the sale. Consequently, the policy premium is based on a best estimate of those costs.

To develop these best estimates insurers rely on information from a large number of losses over a significant period of time. Few insurers, however, have enough information on their own to evaluate every type of risk they underwrite. These companies are not able to develop actuarially credible rating information through their internal loss experience alone. This is particularly important for smaller and medium sized companies. Without advisory loss cost data, they would be unable to compete with larger companies. In addition, many insurers rely on the availability of supplemental rating information developed by licensed advisory organizations such as the Insurance Services Offices (ISO) in order to administer their rating programs. This information would not be available if all insurance companies did not report data or were constrained from reporting data as the result of antitrust exposure. Even if the data were available, the cost could be prohibitive if statistical agents had fewer companies over which to spread their production costs.

The state regulatory systems respect the value of advisory loss cost and similar data to competition by compelling insurers to report data and authorizing the compilation and publication of the data by licensed organizations and regulators themselves use such data to analyze trends and evaluate the appropriateness of rates and rating plans. It is the McCarran-Ferguson limited antitrust exemption that provides the legal framework under which the statistical agents collect and analyze the data and insurance companies pool and use the aggregated information.

Consolidated collection and analysis of data and publication of advisory loss costs improve the quality of the market by making it easier for smaller insurers to compete, and offer consumers greater choice. The availability and affordability of advisory loss cost data helps to maintain a blend of both large national firms and smaller regional and state level underwriters in the insurance market. In the absence of such data, smaller and medium sized insurers would confront increased operating expenses which over time could threaten their franchise and participation in the market. The absence of data or significantly more expensive data would also have a chilling effect on the ability of some insurers to expand into new markets or new product lines, further reducing competition and consumer choice.

The limited antitrust exemption also facilitates efficient marketplaces by allowing insurers to form intercompany pools or syndicates to provide high-risk coverage and/or to allow small companies to participate in writing risks that would be unavailable on an individual basis. In addition, the McCarran-Ferguson limited antitrust exemption is key to other cooperative functions such as joint underwriting associations and residual market mechanisms. The development and operation of assigned risk plans, such as those for auto and workers' compensation, with jointly determined rate schedules could be thwarted by limitation or repeal of McCarran-Ferguson. Similarly, participation in state guaranty funds, including monitoring the economic performance of competitors and distribution of losses, could be threatened. The insurance industry by necessity and design plays a hands-on role in administering state guaranty funds. Guaranty funds do not merely serve to replace funds, but to ensure swift and prudent payment of claims, including fraud prevention. These cooperative industry activities provide a critical safety net for insurance consumers and are essential to efficiently operating insurance markets, filling the gap for individuals and businesses otherwise unable to find coverage and ensuring prompt coverage in the event of insolvency.

Over the years there have been numerous proposals to limit or repeal the McCarran-Ferguson limited antitrust exemption. Proponents often ground their calls for repeal or limitation on unproven assertions that the antitrust exemption has led to collusion within the industry; however, there has been no evidence to support these assertions. The industry is highly regulated by state insurance regulators who monitor not only safety and soundness issues, but also any potential anticompetitive and unfair trade practices.

Others have recommended replacing the limited antitrust exemption with a series of "safe harbors" specifically listing the practices of insurance companies that would be exempt from antitrust laws. The safe harbor approach has been rejected by insurers and by Congress since the early 1990s. While the adoption of safe harbors may seem simple and appealing on the surface, insurers and Congress have consistently recognized the numerous potential pitfalls. First, it is impossible to craft a comprehensive list of safe harbors for all the current and future data and information needs of the industry. Second, the safe harbor provisions would serve as an invitation to litigation. The legal uncertainty could reduce the willingness of insurer's to engage in pro-competitive, efficiency-enhancing cooperative activities. Finally, no matter how carefully drafted, safe harbor provisions would prove inefficient in protecting current operations and would lack the flexibility to adapt to changing innovations and business practices.

In addition, if safe harbors were crafted or interpreted to "allow" but not "require" certain data reporting additional unattended consequences could occur. If participation in rate advisory organizations would be held to be at the election of individual companies it would threaten the quantity and quality of the underlying data. The data availability issue would not be resolved by merely preserving the ability to exchange information. Current industry-wide reporting and sharing requirements which are essential to the production of credible advisory information must also be preserved.

The Insurance Industry Competition Act of 2007 (S. 681) would repeal the McCarran-Ferguson Act's authority to regulate the business of insurance "as it relates to unfair competition" and would authorize the Federal Trade Commission to regulate unfair competition and other areas of the business of insurance "to the extent not regulated by the states." The dual regulatory system set up by the legislation would not make the insurance industry more competitive and would not benefit the policyholder's it serves. NAMIC urges the Committee and the Congress to oppose S. 681.

The existence of the McCarran-Ferguson limited antitrust exemption makes the industry more competitive, not less. Proposals to repeal or limit the exemptions would threaten activities that have increased competition and provided significant benefits to America's consumers. It is highly likely that rather than increasing competition, repeal or limitation of the McCarran-Ferguson limited exemption would perversely reduce competition, increase insurance costs and reduce availability for some high-risk coverages.

Congress should be wary of the unintended consequences of changes to the current limited antitrust exemption. Any change that precludes, restricts or even merely discourages the production and exchange of advisory loss costs and supplementary rating information could place smaller and regional firms at a distinct disadvantage, increase consumer costs, reduce consumer choice and seriously undermine competition. There is no credible evidence that the cost, availability or quality of insurance products would be enhanced if the McCarran-Ferguson limited antitrust exemptions were repealed or modified or if enforcement authority were shifted to the federal government.

Any change in the existing antitrust regime including repeal or modification to the current limitations or transfer of enforcement authority could decrease market stability, reduce affordability and availability of products, stifle innovation and expansion, diminish industry efficiency and, ultimately, inhibit rather than increase competition in the insurance marketplace.

NAMIC appreciates the opportunity to submit its comments to the Committee and stands ready to assist the Committee.

National Association of Professional Insurance Agents

Statement to the Senate Judiciary Committee by the
National Association of Professional Insurance Agents
The McCarran-Ferguson Act and Anti-Trust Immunity: Good for Consumers?
March 7, 2007

The National Association of Professional Insurance Agents is opposed to the Insurance Industry Competition Act of 2007 (S. 618). We support the McCarran-Ferguson Act and oppose its repeal.

In addition to proposing the repeal of the limited antitrust exemption under McCarran-Ferguson, it is important to realize what else this bill would do. S. 618 would permit both the Federal Trade Commission (FTC) and the U.S. Department of Justice to enforce federal antitrust laws and regulations on the insurance industry. This would create an overlapping insurance jurisdiction at the federal level that would create broad conflicts in established insurance law. This would conflict with existing state oversight and the body of state insurance laws and legal precedents established over the past six decades.

A dual regulatory environment would effectively turn over insurance oversight authority matters to the courts, which would be called upon to resolve the conflicts such a system would create. This would foster marketplace instability, harming insurance consumers and carriers alike, and throw open the doors of the nation's judicial system to a flood of new litigation.

The Insurance Industry Competition Act would replace McCarran's specific grant of insurance regulatory authority to the states with a "state action doctrine." While McCarran grants the authority to the states, the state action doctrine under is a mere legal premise for the states to "argue" that they have authority, subject to continuing interpretation by the courts on a case-by-case basis. The Insurance Industry Competition Act is a back-door attempt to bring about a federal takeover of insurance regulation.

This bill is a powerful prescription for unintended consequences. It would inadvertently turn over oversight authority matters to the courts. It does nothing to advance insurance regulatory modernization; in fact, it would bring modernization efforts to a halt by creating a legal morass that would stifle open competition by insurers, both large and small.

While the frustration experienced by Members of Congress and their constituents in the aftermath of Hurricane Katrina is understandable, and the actions of some insurers raise legitimate questions, this bill will ruin the insurance marketplace countrywide. We have a good system of insurance regulation now. This bill would replace it with no system. It would ultimately be hurtful to the very consumers it is designed to help.

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National Council on Compensation Insurance, Inc.

Mary Jane Cleary
Washington Affairs Executive and Counsel

March 14, 2007

Ms. Nikole Burroughs
Majority Office
Senate Judiciary Committee
Dirksen Bldg.
Washington, DC 20510

Re: S. 618—Repeal of McCarran-Ferguson
federal antitrust exemption

Dear Ms. Burroughs,

The work of our organization, the National Council on Compensation Insurance (NCCI), and, in turn, the small- and medium-sized insurance companies and the employers to whom they sell workers' compensation insurance in our states and the District of Columbia, could potentially be significantly impacted by the passage of "The Insurance Industry Competition Act of 2007" (S. 618).

NCCI operates as a not-for-profit workers' compensation insurance data and analysis organization in 34 states and the District of Columbia. In every state but Texas most employers are required to buy workers' compensation insurance to cover their employees in the event of an on-the-job injury. NCCI's work, which is highly regulated by the state insurance commissioners, provides data to the insurance departments on behalf of all of the workers' compensation insurance companies which sell this insurance in each of these states. Because the states have actuarial requirements which must be met and the small- and medium-sized insurers usually do not have sufficient data to meet these requirements in most states, NCCI's data is generally used by these companies to meet that requirement. In turn, this allows the state's insurance agents and brokers to have more markets available to provide such insurance to the employers at the best cost. (This also may be true for the largest companies in states in which they do not have sufficient data of their own.)

Attached are the two Comment letters which NCCI provided to the Antirust Modernization Commission which explain what we do and why keeping the McCarran-Ferguson antitrust exemption, which is a limited exemption, is important to all parties in the workers' compensation insurance system.

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Please feel free to contact me if you have any questions about this information. We very much appreciate your consideration.

Yours truly,

Mary Jane Cleary

Mary Jane Cleary

National Council on Compensation Insurance, Inc.

Mary Jane Cleary
Washington Affairs Executive and Counsel

November 1, 2006

Ms. Deborah A. Garza
Chairperson
Antitrust Modernization Commission
1120 G St., NW, Suite 810
Washington, DC 20005

Re: Follow-up Comments regarding the McCarran-Ferguson Act testimony

Dear Chairperson Garza,

Given that much of the questioning of the witnesses at the October 18 hearing dealt with data collection, "trending", and, implicitly, collective ratemaking activities, we at the National Council on Compensation Insurance (NCCI) thought it would be helpful to supplement the information provided by those witnesses.

Terrence Delehanty, NCCI's General Counsel and Chief Legal Officer, submitted a comment letter to the Commission on July 15, 2005, part of which explained the purpose and activities of NCCI. While I would commend that earlier letter to you for further information, the activities of NCCI that are most relevant here are our data collection process and ratemaking activities. It should be noted that we deal only with workers compensation insurance.

NCCI is regulated by the state insurance departments in the 34 states in which we do business. In all of those states but five, the state law requires that NCCI make annual proposed changes to the current average employer occupation costs, which are called "loss costs". State law in some states defines "loss costs" in one of two manners. In some states "loss costs" means historical loss data combined with loss development and trend to project the likely "losses"/payouts to employees during the coming fiscal year. In other states, "loss costs" means historical loss data combined with loss adjustment expenses and loss development and trend to project the likely "losses"/payouts" for the coming fiscal year. Four of the five "exception" states are: Florida, Arizona, Iowa, and Idaho. (The remaining state, Illinois, is addressed below.)

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In these states, once the state insurance regulator approves the "loss costs", NCCI notifies the companies which sell workers compensation insurance in those states. Thereafter, the insurance companies that want to sell such insurance are required by state law to file a "multiplier" for approval by the state insurance regulator. The "multiplier" reflects, among other things, an insurance company's expenses and business considerations. The use of the approved "loss costs" and an insurance company's own multiplier facilitates greater pricing freedom than in the past when states used "final rates" that included both "loss costs" and average industry expenses.

In 19 of the 34 NCCI states, the states require NCCI to administer the "residual" or "alternative" or "involuntary" market in those states on behalf of all of the insurance companies selling workers compensation insurance in those states. (Since workers compensation insurance is mandatory for most employers in all jurisdictions except Texas, the "residual" market provides a mechanism for employers who cannot find an insurance company to sell them coverage for their employees.) In those 19 states NCCI is required to file proposed "final rates" for the coming fiscal year. "Final rates" include historic data, loss development and trend, an expense component, premium and other state taxes, and a small "profit factor". (The primary reason for states generally requiring NCCI to file "final rates" for the residual markets is to have them operate them on a break-even basis.)

In the 20th state, Tennessee, the state insurance regulator requires NCCI to file a "multiplier" for the residual market, though the market is run by another entity. Once the regulator has approved that "multiplier", NCCI converts those numbers to "final rates" for each occupational classification in the residual market.

In the state of Illinois, the state insurance regulator requires NCCI to make three filings: one each for "final rates" and "loss costs" for the voluntary market and "final rates" for the residual market. The purpose of the "final rates" voluntary market filing is to help those companies which otherwise would not be able to do business in the state because they could not meet the "loss costs" and "multiplier" filing requirements. Illinois has insurance companies of every size, from the very largest to the very smallest. (Those falling into the latter category are generally called "farm mutuals" or "county mutuals", which developed on a historical basis.)

The use of "loss development" and "trending" in workers compensation insurance filings is important for several reasons, the most important of which is to make certain that premiums are adequate to cover anticipated losses during the year or more in which those filings are effective. Quite often NCCI's "loss costs" and "final rate" filings are the subject of public comment periods and public hearings. This typically results in delay of the approval of these filings and their implementation. "Loss development" and "trending" are important tools to guard against the possibility of "rates" and "loss costs" becoming inadequate during their effective period. They are also a means of making certain that premiums are sufficient to cover claims that develop and require payments over a number of years, some of which could cover decades. (After the state insurance regulator approves the filing, neither NCCI nor any company can return to the regulator for approval of higher "loss costs" or "final rates" if they are determined to be insufficient during that time period.)

We reiterate our earlier reasons for leaving the McCarran-Ferguson Act intact. The Act has provided a solid legal foundation for NCCI and other rating organizations to be involved with loss development and trending. If the Act were to be modified it would create substantial uncertainty as to whether or not rating organizations could perform these critical steps in the ratemaking process. Additionally, the McCarran Act has added greater stability to what can be at times a very volatile workers compensation insurance market.

If you have any questions about the contents of this letter, please feel free to contact me. Thank you for your consideration of these comments and those that we filed earlier.

Mary Jane Cleary

c: Terrence Delehanty, NCCI General Counsel and Chief Legal Officer

NCCI Holdings, Inc.

Terrence D. Delehanty
General Counsel and
Chief Legal Officer

July 15, 2005

Antitrust Modernization Commission
Attn: Public Comments
1120 G Street, N.W., Suite 810
Washington, D.C. 20005

Re: Public Comment on Immunities and Exemptions (McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15)

Dear Commissioners:

NCCI Holdings, Inc. believes that the McCarran-Ferguson Act (the "Act") has provided substantial benefits to the insurance industry and the nation's economy and that the Act should remain in force without modification.

BACKGROUND

NCCI Holdings, Inc. operates as a not-for-profit corporation whose members include substantially all insurance carriers writing workers' compensation insurance in the United States, as well as numerous state funds. Through its subsidiary, National Council on Compensation, Inc. (collectively "NCCI"), NCCI studies workplace injuries and other national and state factors impacting workers compensation, provides analysis of industry trends, prepares recommendations for workers compensation rates and loss costs, and assesses the costs of proposed workers compensation legislation. It also provides a variety of data products to over nine hundred insurance companies and nearly forty state governments. NCCI works actively with state regulators, insurers, trade associations, and business, industry and labor coalitions to maintain a healthy workers compensation system and to reduce the frequency of employee injuries.

Since its passage in 1945, the Act has enhanced the ability of the insurance industry to work collectively through NCCI, resulting in substantial benefits for American businesses and the American economy.

The laws of every (or virtually every) state require employers to purchase workers compensation insurance or to self-insure in order to safeguard their employees. Employers thus need access to insurance markets with sufficient capacity to provide this legislatively mandated coverage. The Act promotes healthy insurance markets by permitting insurers of all sizes to participate in, and avail themselves of, NCCI products and services that are vitally important to their writing of

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workers compensation insurance. This includes, by way of example, the collection and analysis of historic loss data, the determination of loss development factors for use in ratemaking, and the development of standard insurance policy forms. Many smaller and medium-sized carriers do not have the resources to create these products and services for themselves, and thus their ability to write workers compensation insurance could be reduced or curtailed in one or more states if changes in the Act impacted carriers' opportunity to participate in collective or joint activities. Even larger carriers, with substantial financial wherewithal, benefit from these activities particularly in states where their own experience is insufficient to make meaningful assessments of rates and loss costs. These collective actions thus make it easier for employers to obtain workers compensation insurance.

The enhanced underwriting capacity facilitated by the Act has also had a positive impact on the premiums that employers pay for their workers compensation insurance. Increased capacity has resulted in more competition in the marketplace with greater options for employers seeking workers compensation insurance.

The following items are of primary concern regarding any modification or repeal of the McCarran-Ferguson Act:

- ***Trending. Access to aggregate industry loss data compiled regularly on a uniform basis, which takes into account how future movements of claim costs and premiums might diverge from historical levels based on payroll and premiums versus indemnity and medical costs, must be maintained so that insurers can accurately predict future costs.***

The Act has facilitated NCCI's work on loss development and trending, which are necessary steps in making rates or loss costs. While ratemaking starts with the accumulation and analysis of historical data on transactions that have already taken place, it cannot be concluded until experienced actuaries develop those losses by projecting their future magnitude and also by projecting future trends that are likely to impact losses. Collective efforts in loss development and trending enhance insurance capacity by enabling a broad range of insurers to offer policies for premiums that attempt to reflect future losses adequately. Use of the services of rating agencies also reduces the costs of meeting state regulatory requirements, making it possible for more carriers to offer coverage at lower prices.

- ***Experience Rating. A uniform, consistently administered method of determining a business's loss history must be protected in order to place maximum pressure on employers to maintain a high level of workplace safety and to ensure that safety-conscious insureds aren't forced to subsidize unsafe businesses.***

Tailoring filed rates and loss costs to the experience of individual insureds is also enhanced by the Act. In many states throughout the country, NCCI has filed, and operates, experience rating plans that are designed to adjust rates and loss costs to reflect the loss experience of employers (in comparison to the average experience of similarly situated businesses). These plans require carriers to have access, through NCCI, to historical information about employers often during periods when they were insured by a competing insurer. NCCI has also developed scheduled rating plans that are used, typically with large commercial insurance risks, to take into account a variety of specific factors in the pricing of their workers compensation insurance policies.

- ***Policy Forms. Standardized insurance policy forms and endorsements and guidelines must be developed, prepared and utilized if consumers are to have the ability to shop competitively.***

The Act promotes the development of standardized insurance policy forms which promotes competition and enhances consumer welfare. Standardized insurance forms enhance consumer choice by making it easier for employers to compare prices from different insurers without having to consider essential policy terms that might otherwise be written in complex, varying language. Standardized policy language also facilitates uniform judicial interpretation, thus reducing uncertainty and improving employers' ability to make decisions on insurance purchases. Standardization of forms also can reduce regulatory compliance costs, by minimizing duplicative regulatory review of numerous forms. More efficient regulatory review can often reduce delays in the introduction of new insurance products to the ultimate benefit of employers purchasing workers compensation insurance.

- ***Residual Market. Joint activities are essential if the insurance industry is to provide a "safety net" for those unable to secure coverage in the voluntary market while being subject to mandatory insurance requirements.***

The Act has contributed positively to the development of state created workers compensation insurance plans (sometimes referred to as the residual market or the assigned risk plan) for employers that are required by law to have workers compensation insurance but is unavailable to purchase such coverage in the voluntary market. The Act facilitates the very existence of these workers compensation plans by enabling insurers to work collectively through NCCI to provide sufficient capacity in the residual market. The Act also facilitates the existence of the National Workers Compensation Reinsurance Pool, a reinsurance arrangement among participating insurers that reinsures on a pro rata basis policies issued in the residual market. This pooling arrangement limits the exposure of any single insurer and thus helps to make available that coverage which no single insurer would be able to assume alone.

- ***Law Evaluations. NCCI's collection and analyses of information on the cost impact that legislative or regulatory changes have on workers compensation is an important service that allows state legislators the opportunity to make informed choices when considering legislative changes.***

Government officials benefit from NCCI's services. NCCI regularly provides state legislators and insurance regulators with information about the potential impact of changes or proposed changes in state workers compensation laws. Many of these changes directly impact the amounts that injured workers are paid as a result of their being injured and/or missing time from their jobs. NCCI's ability to perform this vital service is dependent upon its ability to gather policy and claim data from insurers and state funds.

- ***Research. Insurers and organizations like NCCI must be allowed to work together to conduct valuable research on topics such as the causes and prevention of losses, the***

impact of benefit level changes on utilization of the system, and economic and social trends that affect the system.

SUMMARY

There are a number of facts that sets the workers compensation industry apart from others including:

- According to state law, workers compensation is mandatory for all employers, with rare exception.
- State law dictates the terms of workers compensation benefits provided to employees.
- A workers compensation insurer is potentially subject to unlimited liability.

Modification or repeal of the Act would create uncertainty about the legal ramifications of collective or joint activities undertaken by the insurance industry. That uncertainty could jeopardize many of the benefits that American businesses and the American economy have realized as a result of the Act. The Act should not be repealed or modified.

Very truly yours,

Terrence D. Delehanty

Comments of the Property Casualty Insurers Association of America to the Senate Judiciary Committee on S. 618, Insurance Industry Competition Act of 2007

PCI is uniquely positioned to speak to issues concerning S. 618 and modification of the McCarran limited exemption from federal antitrust provisions. The PCI in one entity comprises the broadest cross section of insurance industry interests in the nation. With over 1000 members writing over $194 billion in annual premium in all states, our members are stock, mutual, reciprocal and Lloyd's in form. Members write nearly 40 percent of all the property/casualty insurance written in the United States. PCI members write 49.5 percent of the nation's auto insurance, 38.3 percent of the homeowners' policies, 31.5 percent of the business insurance policies, and 40.2 percent of the private workers' compensations market. PCI members write on an admitted basis, on a surplus lines basis, or as risk retention groups. Products are sold through: agents: captive, employee, independent and other; brokers; wholesalers; surplus lines brokers; managing general agents; directly via telephone and internet; or directly by the company. Members are insurers and reinsurers. They are national, regional, or single state, ranging in size from the very small to those well known as the largest insurers in the country. There are multi-line writers, personal lines-only writers, commercial lines-only writers, specialty writers and monoline writers. PCI members write virtually all lines of business.

The Current Situation Under McCarran

Our comments focus on two aspects relating to S.618, the current situation and what could happen under S. 618. First, there has not been evidence of a need to change current law. McCarran has worked well for over 60 years to foster a competitive insurance market. It is a limited exemption, applying only to the "business of insurance" and only to the "extent regulated by state law." These definitions are critical to discussion of McCarran, and have evolved as a known quantity as the result of court decisions and practices. It is also limited in that McCarran affords no protection for acts of boycott, coercion or intimidation.

Activity relating to the business of insurance has been, in fact, narrowly defined by the U.S Supreme Court in relation to McCarran. In its three prong test, the Court determined that the practice must: 1) have the effect of transferring or spreading a policyholder's risk; 2) be an integral part of the policy relationship between the insurer and the insured; and 3) be limited to entities within the insurance industry. That test has become the guidance under which those wishing to avail themselves of the limited exemption measure their activities and choose whether engage in a given activity. Thus, for example, agreements with third party vendors for services, related to but not part of, the "business of insurance" do not have McCarran protection. Insurers know that for operating under the limited exemption they must engage in activities relating to the business of insurance.

Unfounded Criticisms

There have been comments made expressing concerns that the phrase to the "extent regulated by state law" is weak and allows the insurance industry to operate where states have failed to regulate insurance. The examples cited claim or infer that the states have failed to regulate, focusing on recent situations relating to bid rigging and other illegal activities. That is simply untrue. There are two aspects involved here. The first is that it is virtually impossible for any form of regulation to be able to prevent fraud and related misconduct. Otherwise, Enron would have never occurred, despite SEC regulation. Nor would aspects of the savings and loan crisis have occurred. However, regulation can respond to minimize future concerns, such as Sarbanes Oxley did, and what the insurance regulators did after bid rigging was exposed. Insurance regulators made further inquires as to how pervasive the problem was, using subpoenas to obtain massive amounts of information; started a hotline for related complaints; and considered model laws proposed by a number of groups to enact should a state believe the problem required new legislation.

The second important aspect is that the state system worked. The New York Department of Insurance reported its concerns to and coordinated with the State's Attorney General, the latter office being the one charged with enforcement of the laws which were violated. Actions were also filed by attorneys general in other states. Settlements did happen. The cited activities ceased. Business practices changed and were altered to encourage greater transparency in brokered transactions.

Another purported need for a change is that there are alleged collusive activities by the insurance industry. "Collusion" is defined by Webster as "secret agreement or cooperation especially for an illegal or deceitful purpose." Yet no case of collusion that was shielded by McCarran has actually been identified in the testimony by anyone. For example, the use of the Colossus system was cited in testimony by Mr. Hunter. His testimony cites the sales material for Colossus with a reference to settlements and lawsuits relating to the handling of claims. There is an assertion that most insurers use that vendor, from which collusion is inferred. Such an inference is tantamount to saying that customers who use the country's largest express delivery service or use the most popular computer operating system are engaging in collusion. Whether there is antitrust activity at all, and whether McCarran interfered in any way with enforcement cannot be determined from this innuendo.

Insurance Market Competitive and Varied

The insurance market is highly competitive, not in spite of McCarran, but because of it. In 2005, over 2,750 individual property casualty companies were writing insurance in the United States. One reason for this is the existence of McCarran, which allows small to medium companies access to statistically reliable information so that they can correctly price their product to reflect potential losses. Even a large company may need such information prior to entering a new line of business and McCarran also permits large companies to have access to such information. As a result, entry and participation in markets is enhanced, adding to consumer choice.

Company solvency is also supported by McCarran because correct loss based pricing is the foundation of actuarially sound rates. This is because insurance is one of the few products where the actual cost is not known until years after the product is sold. Data aggregation by insurers is therefore of the utmost importance to consumers in being able to do business with financially strong companies.

The "insurance industry" is also not monolithic. Approximately 95% of all companies write less than $1 Billion in premium and are highly varied in the markets they serve.* Small and medium-sized insurers are more regional in nature, servicing tightly defined markets and consumer market segments. They are often highly specialized, possessing unique knowledge of their market niches in terms of customer needs, the legal and business environments, and how to service the business. Given their size and the scale disadvantages they sometimes face in the market, most are highly focused on consumer service and risk management, providing significant benefits to their policyholders. Their loss from these markets would be a loss of consumer choice and consumer services. Just a few examples of the niches filled by such insurers include providing insurance to churches; specialized workers compensation areas; ocean marine offshore energy, transport, cargo and fishing vessels; the mining industry; entertainment parks; jewelers; small artisan contractors; colleges and schools; contractors in the Gulf coast states and the alternative market for coverages provided by surplus lines insurers.

Again, from a consumer perspective, the continued viability of this market segment is critical, as those companies are often the ones to bring pricing and product pressure to bear on the larger competitors.

Product Comparability

Without McCarran, insurers may be reluctant to use common policy forms, the existence of which is another benefit to the consumer. Common forms allow the consumer to compare apples to apples. Given the complexity of insurance agreements, common forms allow meaningful comparison shopping. Additionally, these common forms provide a greater level of certainty as to the legal outcome of interpretations of policy language, for both policyholders and insurers, which helps to increase new market entrants, benefiting consumers again by greater competition. That same certainty decreases the likelihood of insolvency as insurers will pay only those claims which were priced for when the policy was sold, again protecting consumers. Further, without

* As to small to medium insurers, PCI, in looking at the size of various insurance organizations on issues relating to TRIA, found that only 65 companies or groups of companies had direct earned premium of over $1 billion in 2005. However, over 1400 companies or groups had direct earned premium under that amount. That is 6% large size group versus 94% small to medium insurers. Small and medium-sized insurers are significant employers, estimated to employ some 220,000 people nationwide, with a payroll exceeding $11.6 billion. The "downstream" annual economic impact of the payroll provided by these insurers is estimated to be over $17.5 billion. Almost one-quarter (24 percent) of the property/casualty industry's federal income taxes are paid by small and medium-sized TRIA insurers.

common forms, the aggregation of data described above would be extremely difficult if not impossible. Finally, common forms permit consumers to substitute a new company for an insolvent one without significantly disrupting the scope of coverage they enjoy, when insolvencies do occur.

Other Benefits of McCarran

McCarran protects consumers in other ways, as well. When an insurer becomes insolvent, it allows the insurers to work jointly in terms of guaranty associations in the states. Insurers pay assessments to fund claims owed by an insolvent company to the guaranty association to provide a limited safety net for those cases where the consumer would otherwise be without payment due to insolvency. S. 618 could prevent insurers from acting jointly to protect consumers via guaranty associations deliberations. One might argue that guaranty association activities are protected under the state action doctrine, but from a business perspective, it is a risky move for insurers to participate without the certainty offered by McCarran.

And McCarran also protects those who cannot buy the insurance that a state mandates, by permitting insurers to work together in terms of residual markets and joint underwriting associations. Personal lines automobile, workers compensation, some professional liability lines, and other coverages are often mandated by a state. Other economically critical coverages such as homeowners might simply not be available cheaply. These markets provide coverages to those who cannot find coverage. Competing insurers have worked jointly to support these mechanisms by bringing their added capacity, expertise, and oversight. S. 618 would discourage insurers from willing participation to provide this alternative to the consumer.

The Situation Should S. 618 Pass

Our second major point relates to what could happen under an enacted S. 618. Business uncertainty would increase very significantly, to consumers' detriment. There has been much talk that repeal of McCarran will increase competition. The opposite is far more likely to occur. S. 618 will impose a chilling effect upon businesses as they try to decide whether or not an activity is clearly permissible, for if there is uncertainty, businesses will look to allocate capital elsewhere. There will be fewer competitors, a situation which only hurts the consumer.

First and foremost, what S. 618 would do is to bring to bear a body of law and interpretation that evolved while insurance was excluded from its requirements. The result would be pervasive uncertainty as to the meaning of those laws when applied to insurance. It is impossible to project all the ways such a change would impact insurers and their customers except to say that the cost will be high and ultimately will be borne by consumers. Accordingly, the premise that lower prices and more varied products would automatically result is faulty.

Much has been said about the "state action doctrine" and the notion that insurers can rely on it successfully without McCarran. However, the state action doctrine is more about litigation than it is a tool for business planning. The action must be "clearly articulated and affirmatively expressed as policy" and "actively supervised by the state itself." PCI agrees that the doctrine could be applied in the event of a question of whether or not antitrust laws are preempted, but the issue is that an insurer would first engage in the activity *at its peril* (emphasis added). The state action doctrine does not assist the businessperson trying to determine an acceptable course of action, it is at best a defense to litigation brought after a business decision has been implemented. Regardless of the correctness of the decision, that same businessperson will only know whether the doctrine affords protection after expensive litigation. Competition can only be hurt by repeal of McCarran, regardless of the state action doctrine.

S. 618 will create additional regulation without clear benefit to the consumer and will hurt the consumer in decreased competition. We have already spoken of the current need and benefit of sharing information as to losses and common policy forms and the solvency implications thereunder. Congress certainly can determine that it is acceptable for an insurer to go insolvent and make it harder for an insurer to remain solvent via the use of good data. This is the way of the free market. However, that is tempered by the imposition as a matter of public policy by state legislatures that there be a guaranty association to pay the claims of insolvent companies. There will be additional claims to be paid by this guaranty association mechanism if good information is not available to insurers. Congress must realize it is imposing this burden on the states via S. 618. Even further, it may be effectively preventing insurers from actively supporting guaranty associations under S. 618. Most of all, policyholders will hear the ultimate cast, because they are billed for the assessments.

Companies may also have to cease participating on residual market boards for fear of antitrust exposure. Residual markets are an attempt to address a reality of competitive markets: That some consumers may not be able to buy a needed product. Congress must then answer the question: "Where will those consumers look for their coverage, often mandated by state laws?"

We also need to turn to the two levels of uncertainty that S. 618 will add to the decision making process relating to insurance. The first is the granting of authority in the FTC as it pertains unfair methods of competition. This will be a new power, the extent of which is unknown. While the FTC already has the power not only to investigate potential antitrust violations, S. 618 will be a new extension to insurance. The FTC will be able to apply its broad authority to view a particular insurance activity as an unfair method of competition, beyond antitrust law. The FTC will be able to issue guidance as to how insurers should operate under a given fact pattern, similar to the private letter rulings of the IRS. However, this guidance will be of little value to the businessperson. Businesspeople need answers to antitrust implications of engaging in an activity prior to actually engaging in the activity. We note that guidance that has been given pertaining to the healthcare industry are couched in terms of being limited to the particular fact situation. The guidance can be changed, however, should the FTC's position change.

Additionally, the FTC will have power over areas other than unfair methods of competition to the extent not regulated by state law. This clearly poses the problem of state versus federal regulation. What will result will be turf battles of regulators with the insurers in the middle. There will be the possibility for an insurer to obey one regulator and be in violation of the position of another. While the phrase, "to the extent not regulated by state law" is in existing law, this language may take on new meaning with Congress using it in a new context. For example, the meaning could move more toward a test similar to the state action doctrine and away from the accepted understanding under McCarran.

Finally, PCI notes that absent identity theft complaints, the FTC handles about the same number of complaint annually as state insurance departments. S 618 could double the number of complaints received by the FTC, raising the issue of a greatly increased staffing at the FTC or greatly decreased responsiveness to complaints.

PCI urges Congress not to pass S. 618 as the current system of insurance regulation under McCarran has worked well for over 60 years, with established case law and interpretation giving business the certainty needed to engage in the activities surrounding insurance. Insurance is a complex and comprehensive system of consumer protections, evolved over many years, addressing solvency, availability and other elements. S 618 would replace it with higher costs to the consumer resulting from uncertainty, a reduction in competition and increased risk for participating in the market.

UNITED STATE SENATE
COMMITTEE ON THE JUDICIARY
"THE MCCARRAN-FERGUSON ACT AND ANTITRUST IMMUNITY: GOOD FOR CONSUMERS?"
MARCH 7, 2007

MARC RACICOT
PRESIDENT
AMERICAN INSURANCE ASSOCIATION

Good morning, Chairman Leahy, Ranking Member Specter, and members of the Committee. My name is Marc Racicot. I am President of the American Insurance Association (AIA), a national trade association representing major property and casualty insurers doing business across the country and around the world. I am proud to have spent much of my professional life in public service, including 8 years as the Governor of Montana, and 4 years prior to that as the State's Attorney General. Because of this experience, I have come to respect and appreciate the various responsibilities among and within the branches of state government, the complex relationships between state and federal government, the value of a stable and certain regulatory climate, and the impact of that climate on individuals and businesses. All of these issues are on display when discussing the McCarran-Ferguson Act (McCarran).

Last June, I had the privilege of testifying before this Committee on McCarran, and I appreciate the opportunity to be here again today. I would like to elaborate on three important aspects of the McCarran debate:

1. The role of McCarran in establishing the balance between regulation and antitrust enforcement for the insurance industry.

2. The scope and dimensions of McCarran's limited protection from federal antitrust laws.

3. The negative consequences that would flow from the repeal of McCarran's antitrust exemption.

McCarran's Balance of Regulatory and Antitrust Policy

McCarran was the product of extensive deliberations in Congress during the period following the 1944 U.S. Supreme Court decision in *United States v. South-Eastern Underwriters*. That decision held that insurance was a product that moved in interstate commerce, and was therefore subject to federal jurisdiction. At the time, the decision was controversial, and called into question the states' continued ability to tax and regulate the business of insurance. Further, at the time, the Court's conclusion that insurance was a product within federal Commerce Clause jurisdiction threatened the viability of the insurance system, particularly since *Southeastern Underwriters* was a "price fixing" case, which immediately made many necessary, collective insurance activities subject to federal antitrust laws.

In the nine months following *South-Eastern Underwriters*, Congress labored to enact federal legislation that accomplished three goals: 1) delegation of authority to the states to the extent that the states regulate the business of insurance; 2) creation and maintenance of a broad insurance regulatory system; and 3) balancing regulatory objectives against antitrust policy objectives.

McCarran's enactment furthered all three congressional goals. It entrusted to the states the authority to regulate and tax "the business of insurance," and said that no federal law should be presumed to interfere with that authority, unless it was clearly designed to do so. It gave the states three years from the 1945 enactment to put their regulatory systems in place, effectively suspending the application of the federal antitrust laws during this period. Finally, McCarran said that the federal antitrust laws would apply to the business of insurance "to the extent that such business is not regulated by State Law," or in any case where insurers had engaged in – or agreed to engage in – an act of boycott, intimidation or coercion. (15 U.S.C. Chapter 20, §§ 1012(b), 1013(b)).

In this way, McCarran authorized the states to determine how the balance of state regulatory oversight and federal antitrust enforcement would be drawn, knowing that the federal antitrust laws would apply to the business of insurance to the extent that a state chose not to regulate it.

The balancing of regulation and antitrust policy is familiar to those of us that have had extensive experience in government, particularly at the state level. The determination of how to draw the balance does not differ from industry to industry, but reflects an approach aimed at ensuring a certain and stable legal and regulatory environment that benefits all stakeholders and results in healthy private markets. That approach follows a simple principle: where there is an effective regulatory system in place, antitrust laws should not be used as a way to duplicate it. Conversely, where activity takes place outside the regulatory system, antitrust laws should apply to assure that otherwise regulated entities do not engage in anti-competitive behavior. This is a basic separation of powers principle that defines the distinct roles of the courts (and the state attorneys and private attorneys as officers of the court) and the executive branch regulatory agencies.

In the years following McCarran's enactment, the states used this approach as their roadmap, placing all collective activity by insurers under regulatory control, scrutiny and review – effectively replacing antitrust litigation through the courts with regulatory oversight of collective activity by state insurance departments, including activity to: (1) gather, analyze, and make predictions about data; (2) establish final prices; and, (3) create standardized insurance policy forms. Over the years, this basic approach has remained unchanged, except that state laws now overwhelmingly prohibit insurers from agreeing on final price, *even under regulatory oversight*.

As part of the regulatory approach taken by the states, every organization that engages in data collection and analysis, or in the development of common policy forms, must be licensed or registered with the states and is subject to direct regulation by them. Any collective activity, including activity done through a licensed or registered entity (generally called an "advisory organization"), is subject to both the antitrust provisions in the state's insurance code and to the state's broad antitrust laws.

Equally important to the states' approach to balancing regulation and antitrust policy, during the 3-year post-McCarran "grace period," all states enhanced their regulatory systems by enacting state unfair competition and trade practices laws directed specifically to insurers. Those state laws included what were referred to as "little Federal Trade Commission (FTC)" statutes, because they adopted the FTC's unfair trade practices requirements and placed them on insurers directly through state law. States also adopted their own prohibitions on acts of boycott, intimidation or coercion by insurers, as well as Sherman Act and Clayton Act-type prohibitions on unfair restraints of trade.

It is safe to say that, in the McCarran world, state insurance regulation – in particular, regulation of insurance price and product options – is pervasive. *Every* state has an extensive insurance code that governs the insurance industry in every conceivable aspect of its operations, from financial solvency to market conduct to economic regulation. *Every* state regulates property-casualty insurance rates or policy forms, and often both. There are literally hundreds of filing requirements that states have implemented to regulate property-casualty insurers' rates and forms.

In addition, state regulation over unfair and deceptive trade practices and methods of competition is equally pervasive. All states have a general antitrust statute or antitrust language in their respective unfair trade practices laws. Most states have both.

We may disagree with the degree of state regulation of the business of insurance, particularly with respect to government economic regulation of rates and the content of policy forms, but there is no doubt that the states enthusiastically carried out McCarran's intent. And, while the degree of regulation of the insurance industry may be atypical, the balancing of regulatory supervision and antitrust litigation – as noted earlier – is not unique to insurance; it also takes place in other financial services industries (i.e., banks and the securities business) where federal courts have held that understanding the balance is critical and that antitrust scrutiny is *inappropriate* where the activity is subject to regulation. (*See, e.g., Gordon v. New York Stock Exchange, Inc.*, 422 U.S. 659 (1975)).

The difference between banking and securities regulation, on the one hand, and insurance regulation, on the other, is that the banking and securities businesses are principally regulated by the federal government, while insurance is principally regulated by the states. This is a particularly important difference when looked at from an antitrust perspective. When *federal* antitrust law is balanced against *federal* regulation for a specific industry, the courts have a long and appropriate history of giving precedence to the specific regulatory system that Congress has set up for that industry over the broad, non-specific language of the antitrust laws that did not have that specific industry in mind.

Since insurance regulation, however, resides primarily at the state level as a result of Congress' delegation of authority under the Commerce Clause, McCarran is necessary to provide the kind of balance of "regulation vs. antitrust" enforcement for insurance as exists for federally regulated banking and securities businesses. This central point in understanding the true role of McCarran merits special emphasis, and is worth repeating: *The McCarran-Ferguson Act balances regulation and antitrust enforcement for state-regulated insurance, just as that same type of balance has been established for the other two legs of the financial services sector, federally regulated banks and securities firms.*

If McCarran did not exist, then the balance between *state* insurance regulation and *federal* antitrust law would be quite different. It would be governed by the "state action" doctrine – an antitrust principle first adopted by the courts in the years immediately prior to McCarran taking effect.

Under the "state action" doctrine, *federal antitrust* laws take precedence over *state regulation*, unless that state regulation is particularly intrusive and essentially replaces marketplace competition. Even in these circumstances, the primacy of the state regulation is dependent on whether the regulatory oversight meets an "active supervision" test, which can be determined only through litigation and which, therefore, means that there will be much litigation. Perhaps constant litigation.

So, for the purposes of state insurance regulation, that balance would be destroyed if McCarran were repealed.

<u>The Parameters of McCarran's Limited Antitrust Protection</u>

I hope that it is clear by now from my testimony that McCarran is less of an "exemption" from federal antitrust laws for the business of insurance and more of an approach that the states have followed in balancing the respective and complementary roles of regulatory oversight and antitrust enforcement. Nonetheless, there has been, and continues to be, a fundamental misunderstanding about the federal antitrust protection provided under McCarran, with advocates of McCarran repeal stating that McCarran provides a *blanket* exemption for insurers from federal antitrust law application, allowing insurers an unfettered right to engage in anticompetitive behavior.

This is not how McCarran's antitrust protection works. The exemption applies only to the "business of insurance" and not to the "business of insurance companies", and only to the extent that the business of insurance is regulated by state law. As I have noted, the exemption does not apply to agreements or acts of boycott, intimidation, or coercion. It does not matter whether those practices are regulated by state law or not – federal antitrust law applies. When determining whether the federal antitrust laws apply, the courts have consistently construed the exemption narrowly.

Equally important, McCarran does not protect insurer misbehavior from scrutiny under the broad range of state laws governing unfair methods of competition and unfair and deceptive trade practices. Every state provides some form of antitrust regulation of insurers, whether through broad state laws based on the federal Sherman and Clayton Acts, antitrust provisions in their insurance codes, or language barring unfair competition in the little FTC acts. Often, states have multiple avenues to address alleged anticompetitive behavior. So there is no lack of state antitrust authority with regard to insurers.

Moreover, the allegations that have been or are being leveled at insurers – whether they are related to private allocations of markets, collective price-fixing, or bid-rigging – can be brought under state antitrust, unfair trade practices, and insurance laws. Indeed, the joint investigations into, and the private litigation over, broker compensation practices are a recent reminder of the ability and willingness of state insurance departments, attorneys general, and private litigants to pursue conduct that they believe violates the law.

Upsetting The Balancing Approach Of McCarran Is Not The Solution

Over its more than 60-year life, we have seen McCarran's antitrust protection blamed whenever there is an affordability/availability problem in any specific line of insurance. The typical "solution" is to call for the repeal of that protection.

However, when the problem subsides in that particular line of insurance, the call for repeal generally also subsides, with those who had argued that McCarran was the cause of the problem never saying that perhaps McCarran should now be credited for curing the problem, as well. If insurer activities under McCarran were the reason that prices went up or insurance became less available, then insurer activities under McCarran must be the reason that those very same prices went down or insurance became more widely available.

The reality is that insurance is like the canary in the mine. When an insurance price spikes or availability shrinks, it is because an underlying problem (e.g., a particular cost driver) needs to be addressed. To be fair to all customers – not to mention to be able to stay in business – insurers must be able to price their policies to cover their likely losses. If they cannot do that, because of government price controls, they will be forced to pull back from the marketplace. This reaction is as inevitable as Newton's apple finding its way from tree to ground. Instead of looking at insurer activity under the McCarran-Ferguson Act as the issue, it would be better to look at the underlying problems and fix them.

With this entire context as background, we have reviewed the Insurance Industry Competition Act of 2007. As we read the Act, it would apply the Sherman and Clayton Acts to the business of insurance, without regard to whether the business was regulated by state law. Moreover, it would apply the FTC Act in the same fashion to the extent that the insurance activity involved an "unfair method of competition." In aspects of the business of insurance unrelated to unfair methods of competition, the FTC Act would apply to "fill the gap" to the extent that those aspects were not regulated by state law. Apparently, the FTC is being authorized to duplicate state regulation wherever it disagrees with a state about its regulatory decisions. Thus, the Act would repeal the McCarran antitrust exemption without changing the state regulatory dynamic and it would super-impose an additional federal layer of regulation.

If our interpretation of the Act is correct, enactment of its provisions would destroy any balance between regulation and antitrust enforcement, and create a multi-layer, multi-forum system of regulation that would generate confusion, uncertainty, constant litigation, and, ultimately, an unstable and unpredictable insurance system.

No one benefits from such a dysfunctional system. State insurance departments could not be certain that the regulatory standards that they promulgate today would not be second-guessed by the courts or the FTC. Insurer activities would be subject to judicial scrutiny under the state action doctrine, ensuring that a different level of regulation would be necessary for that doctrine to apply. Some advocates of McCarran repeal have expressed confidence that certain collective activities currently regulated under state law would not fall within the state action doctrine and therefore would result in antitrust verdicts against insurers. We believe them and have no doubt of their willingness to test their confidence through litigation.

All of these consequences suggest two paths, neither of which is desirable from the standpoint of good government and healthy markets. Either insurers will approach the states to plead for more regulation to foreclose incursions via the courts or federal antitrust enforcement agencies, or insurer practices will be tested through constant litigation – without regard to the level of regulation by the states or the federal government. It seems to me that our goal should not be to encourage over-regulation or duplicative regulation in a system already widely acknowledged to be in need of reform. Likewise, the goal of legislation ought not be the enrichment of antitrust lawyers. The more prudent course would be to find the appropriate balance of regulation and antitrust enforcement of competition *within* McCarran as it exists today. That course does not require repeal of McCarran's narrow antitrust protection, but it does involve a commitment to having a regulatory system that leads to stable, predictable, and healthy insurance markets that benefit consumers. We are prepared to make that commitment.

Mr. Chairman, thank you very much for giving us the opportunity to appear before you today. I would be pleased to answer any questions.

Testimony of the
National Association of Insurance Commissioners

Before the
Committee on the Judiciary
United States Senate

Regarding:

The McCarran-Ferguson Act and Antitrust Immunity: Good for Consumers?

March 7, 2007

Susan E. Voss
Commissioner of Insurance
State of Iowa

Chairman Leahy, Ranking Member Specter, and members of the Judiciary Committee, thank you for inviting me to testify today.

My name is Susan Voss, and I am the Commissioner of Insurance for the State of Iowa. I serve as Vice Chair of the Financial Conditions (E) Committee of the National Association of Insurance Commissioners (NAIC), and on the Board of the National Insurance Producer Registry (NPIR). I also serve on a small NAIC antitrust working group charged with outreach to Congress and evaluation of legislative proposals that would impact the business of insurance.

I am pleased to be here today on behalf of the NAIC and its members to provide the Committee with our initial observations on congressional efforts to repeal the limited antitrust exemption for insurance activities granted by the McCarran-Ferguson Act ("Act"). 15 U.S.C. §1011 *et seq*.

Today, I would like to make a few primary points:

- NAIC supports the intent of Congress to protect consumers by enabling federal investigation and prosecution of bad actors that use the Act as a shield from federal antitrust laws.

- Although the NAIC understands there are practices that should be subject to both federal and state antitrust laws, we ask Congress to carefully evaluate the unintended consequences from outright repeal of the exemption. Repeal risks transforming certain insurance practices that help consumers, promote competitiveness, and strengthen markets, into actionable violations of federal antitrust law.

- NAIC respectfully suggests that identification of the precise offensive conduct Congress wants to prohibit but cannot because current federal law does not permit investigation and prosecution should guide congressional consideration. As this Committee considers outright repeal of the antitrust exemption for the business of insurance, the NAIC asks that you contrast repeal against targeted alternatives, including amendments to strengthen existing criminal and civil actions and remedies that would lower the shield behind which bad actors hide, but preserve insurance market stability. The alleged bad behaviors driving congressional interest are, for the most part, not immune from federal investigation and prosecution under the Act's limited antitrust exemption.

- The NAIC believes that any federal legislation should include provisions that authorize federal-state collaboration to identify, investigate, and prosecute bad actors in the business of insurance who engage in anti-competitive practices.

- Overall, the NAIC would emphasize that a core mission of state regulation is to protect consumer interests. Efforts at regulatory modernization and investigations of alleged abuses demonstrate our commitment to that mission. While some of the insurance industry's largest players advocate for deregulation through a so-called federal charter and would encourage coupling the two issues, the NAIC supports re-consideration of the limited federal antitrust exemption as a separate and distinct policy matter.

The NAIC's antitrust working group, chaired by Illinois Director of Insurance Michael McRaith, represents the current phase in the evolution of the NAIC's position on repeal of the limited federal antitrust exemption. As you may recall, Director McRaith appeared before the Committee last June. He testified that: (i) insurance is a unique financial product, (ii) for which state supervision is well-suited, long-standing, and successful, and

(iii) that the state system operates to prevent and punish anti-competitive practices, demonstrating that (iv) the limited federal antitrust exemption has worked well for decades to maintain a vigorous and competitive market.

Presently, our antitrust working group is reviewing S.618, the *Insurance Industry Competition Act of 2007*, which is pending before this Committee. The Working Group expects to present this matter for discussion by all chief state insurance regulators during the NAIC's upcoming Spring national meeting that begins this weekend in New York City.

Mr. Chairman, if invited, we would be pleased to submit for the hearing record any relevant comments, recommendations, or outcomes from the NAIC Spring national meeting.

Lower the Shield: Prosecute Bad Actors Who Violate Antitrust Laws

The NAIC supports the policy intent that underlies legislative proposals like S. 618. Persons who violate state and federal antitrust laws should be investigated and, where the evidence points to an actionable violation, prosecuted. Currently, the Act gives the insurance industry a limited exemption from federal antitrust laws. An activity that qualifies for the exemption must: (i) constitute the "business of insurance"; (ii) be "regulated by state law"; and, (iii) not constitute "an agreement to boycott, coerce, or intimidate, or [an] act of boycott, coercion, or intimidation." 15 U.S.C. §§1012-1013. If an activity does not meet each of these three criteria, or where Congress enacts a law that "specifically relates to the business of insurance," then the exemption is unavailable. For instance, in 1994, Congress passed and President Clinton signed into law the *Violent Crime Control and Law Enforcement Act of 1994*. Pub. L. 103-322 (1994). The law includes provisions that "specifically relate" to the business of insurance by expanding federal criminal and civil actions against insurance companies engaged in certain acts of fraud, embezzlement, and obstruction of justice. 18 U.S.C. §§1033-1034 (2007).

It is hard to dispute Sen. Specter's remarks in his floor statement introducing S. 618 that "there is no reason to prevent federal prosecutors from going after antitrust violators just because those violators happen to work for insurance companies." 153 Cong. Rec. S2047 (Feb. 15, 2007). However, it is important to recognize that the federal antitrust laws and criminal code, including unfair and deceptive trade practices, already offer a wide range of legal weapons for prosecutors to wield against alleged bad actors. For instance, in the on-going insurance brokerage litigation involving alleged bid-rigging and client steering conspiracies, a federal district judge ruled last October that the challenged practices are not exempt from federal antitrust or RICO actions under the Act. *In re Insurance Brokerage Antitrust Litigation,* Slip Copy, 2006 WL 2850607 (D.N.J.) (Oct. 3, 2006). The judge held that, under the *Pireno* test of the "business of insurance," bid-rigging and client steering do not transfer or spread risk and are only tangentially related to the relationship between an insurer and insured. *Union Life Ins. Co. v. Pireno,* 458 U.S. 119 (1982). The challenged practices involve interactions between brokers and insurers, but are "outside the sphere" of the policy relationship between insurer and insured. *In re Insurance Brokerage Antitrust Lit.* 2006 WL 2850607 at 10.

Of immediate concern to many members of Congress is whether Gulf Coast victims of Hurricanes Katrina and Rita, are victims now of alleged unscrupulous insurance practices. Belief that the limited antitrust exemption blocks federal investigation by the Department of Justice and the Federal Trade Commission overlooks the fact that the alleged unscrupulous practices generally involve claims payment and claims settlement disputes. The Act's limited antitrust exemption does not necessarily shield these matters. Likewise, there are allegations that some insurers colluded not to pay policyholder claims post-Katrina. The crime of "collusion" involves (i) a secret agreement among two or more persons, (ii) to commit a fraudulent act. Collusion would be an actionable offense under federal and state deceptive and unfair trade practices laws, and a prosecutor could perhaps frame an action under Section One of the Sherman Act of 1890. 15 U.S.C. §1. Demonstration of a Section One antitrust violation requires: (i) an agreement (e.g. conspiracy, "collusion"), resulting in (ii) anticompetitive effects (e.g. "restraint of trade"), and (iii) that involves an illegal action, which (iv) was the proximate cause of injury.

Alleged collusion not to pay has, arguably, an anti-competitive effect. It could generate market power in the form of wealth transfer to insurers that injure consumers who, in consideration of expected payouts on legitimate claims, paid premiums to insurers that do not assume the transferred risk by honoring the claims.

Although the shield of the McCarran exemption should not block either federal or state investigation or prosecution of anti-competitive agreements to capture market power, it is possible to distinguish those anti-competitive actions from pro-competitive joint practices, as determined under a "rule of reason" analysis.

Let me be direct: the NAIC is concerned that outright repeal risks ending certain pro-competitive practices when the real culprits are bad actors who engage in alleged unscrupulous anti-competitive practices.

Evaluate Unintended Consequences from Repeal

NAIC respectfully asks Congress to carefully evaluate the unintended consequences for consumers and markets from outright repeal of the limited antitrust exemption for the business of insurance.

Pro-Competitive Practices

S. 618 is a relatively short bill, but with far-reaching implications. As I noted earlier in distinguishing between anti- and pro-competitive practices, outright repeal risks transforming certain insurance practices that promote competitiveness, help consumers, and strengthen markets, into actionable violations of federal antitrust law. Jeopardized practices include, for instance:

(i) Loss Cost Data Sharing. Joint conduct that involves data collection and cost projections to help determine rates and cover and adjust claims; this conduct includes "trending," which involves the analysis of past data for the business of insurance to make actuarial predictions about the future;

(ii) State Insolvency Funds. Operation of guaranty fund associations formed through contributions by insurers into a reserve fund to compensate consumers who suffer loss because of insurer insolvency;

(iii) Policy Form and Standardized Risk Classification. Joint activities among insurers to establish risk classifications and product/form standardization;

(iv) Operation of Ratings Organizations. Ratings/statistical organizations like the Insurance Service Office (ISO) and the National Council on Compensation Insurance (NCCI) that collect and disseminate statistical information, compile aggregated loss cost data, and provide other services that make it easier for small and medium-sized insurers to compete; and,

(v) Joint Underwriting and Residual Market Mechanism. Cooperative activities that provide a "safety net" for individuals and businesses unable to secure coverage in the open market including for automobile insurance, medical malpractice, and workers' compensation.

S. 618 does not provide for exemptions or "safe harbors." Instead, the bill invites the U.S. Federal Trade Commission (FTC) and the U.S. Department of Justice (DOJ) to issue advisory opinions and business reviews, respectively, in response to requests for antitrust guidance on specific proposed conduct in the business of insurance. The bill, however, does not provide details that explain how the review process would operate. The history of joint antitrust enforcement guidance, as applied to health care practices, suggests an expedited process that involves a method of scrutiny comparable to a judicial "rule of reason" analysis. A "rule of reason" analysis is essentially a subjective balancing test between pro-competitive and anti-competitive effects from a particular practice on consumers and markets. Where the pros exceed the cons for a practice or conduct, a decision against federal antitrust prosecution, absent extraordinary circumstances, is likely.

Current federal expertise and capacity necessary to evaluate certain practices and conduct for pro-competitive effects is limited, at best, because of the long and successful history of state regulation over the business of insurance. In contrast, the FTC has its own enforcement history as well as developed case law to evaluate the pro- and anti-competitive effects of certain practices in the health care arena. Should S. 618 and its FTC/DOJ joint antitrust enforcement review provision become law, it would take time for federal officials to become sufficiently expert in the business of insurance. During this ramp-up period, market uncertainty concerning federal and state antitrust enforcement policy would threaten consumers and insurers. Therefore, this Committee may want to consider adding a "firewall" provision that temporarily protects from federal prosecution those practices that come before the FTC and DOJ for antitrust enforcement guidance. This presumption of legality could help maintain stability for the business of insurance during a transition period.

Repeal of the limited federal antitrust exemption for the business of insurance invites unintended consequences that could create market uncertainty and harm consumers. Some of those consequences, according to the U.S. Government Accountability Office (GAO), might include the restriction of new products or insurers from entering the market, limits on product innovation, consumer choice, and competition. GAO-05-816R, McCarran-Ferguson Federal Antitrust Exemption, at 3 (July 28, 2005). Outright repeal jeopardizes: (i) competitive market benefits from the development of joint loss costs and policy language; (ii) standardized risk classifications and policy form language that make data more credible; (iii) consolidated collection and analysis of data that improve quality and aid smaller insurers with responsible rate-setting; and (iv) publication of advisory loss costs and common policy forms that make it less costly for small and medium-sized competitors to enter or expand in the market.

Outright repeal also opens the door for increased litigation to determine whether a certain practice is anti-competitive, or whether a particular state "actively" governs the practice.

Litigating Antitrust Boundaries

Absent certainty in results from the application of FTC/DOJ antitrust enforcement guidelines and a "firewall" provision to provide a bridge of interim stability for consumers and markets, litigation will probably remain a preferred option for a party that seeks to probe the contours of insurer activities to determine which ones withstand federal antitrust scrutiny.

The "State Action" doctrine, first articulated in *Parker v. Brown*, 317 U.S. 341 (1943), provides a defense under federal antitrust law for some regulated conduct of the business of insurance. To raise this defense successfully, a defendant must demonstrate that the challenged practice is "regulated by state law". This requires one to meet an additional two-pronged standard that compels evidence of: (i) a "clearly articulated" state policy (e.g. actual statutory language), and (ii) "active supervision" by the state of its policy. *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980). One challenge with the test, according to a policy director with the FTC, is lack of judicial agreement about how to define and apply the "active supervision" factor to particular state regulations and statutes. Testimony of Maureen Ohlhausen, Director, Office of Policy Planning, U.S. FTC, Before the Antitrust Modernization Commission, September 29, 2005. The U.S. Supreme Court in *Midcal*, for instance, directed states to regulate, monitor, or engage in a "pointed re-examination" of regulatory conduct, dismissing the "gauzy cloak of state involvement" as insufficient to avoid federal antitrust law. *Midcal*, 445 U.S. at 106. Alternatively, the *Ticor Title* Court held that the "purpose of...active supervision inquiry is not to determine whether the State has met some normative standard...Its purpose is to determine whether the State has exercised sufficient independent judgment and control." *FTC v. Ticor Title Co.*, 504 U.S. 621, 634 (1992).

One point for certain is that it will take years of litigation to develop uniform precedents among the circuits. Even assuming that courts apply the "State Action" doctrine uniformly, the likelihood of litigation remains strong because "decisions involving antitrust law are typically based on the facts and circumstances of each case." GAO-05-816R at 2 (2005). Litigation will force states, generally, and state departments of insurance, in particular, to reallocate limited staff and financial resources away from more productive uses. It also may create sufficient uncertainty to chill the introduction of new insurance products, limit options for consumers, and impact prices.

Federal-State Prosecutorial Cooperation

The NAIC understands that Congress wants to be responsive to the public and offer more than a phone number to their state's chief insurance regulator. The NAIC, however, encourages the Congress to approach this policy matter from the perspective of "both-and," not "either-or." We believe this issue invites both federal and state action in a demonstration of cooperative federalism. Any federal legislation should include provisions that authorize federal-state collaboration to identify, investigate, and prosecute bad actors in the business of insurance who engage in anti-competitive practices.

Protecting Consumers at the State Level

Every state has its own antitrust and unfair competition laws. State regulators and attorneys general play complementary and mutually supportive roles in monitoring and investigating insurers, agents, and brokers to prevent and punish activities prohibited by those state laws. Monitoring involves reacting to conditions and changed circumstances. It also involves taking an active role and making adjustments to our methods and policies that anticipate new challenges that threaten consumers and market stability. State regulators' primary responsibility is to regulate the "business of insurance" to maintain a stable insurance market that provides products that offer reasonable benefits to consumers. Every day conscientious and highly skilled regulatory professionals monitor and investigate business activities related to the two major obligations insurers owe to consumers—issuing sound policies and paying claims on time.

Market conduct exams are part of the monitoring system. State insurance officials supervise the market conduct of industry participants by reviewing their business operations through market analysis, periodic examinations, and investigation of specific consumer complaints. When consumers have complaints about homeowners, health, automobile, and life insurance, they readily contact their state insurance departments. State officials earn consumer trust, in part, because they know the towns, cities and communities in which consumers live, and the nuances of the local insurance marketplace. Insurance products are difficult for many consumers to understand. Consumers expect state governments to have appropriate safeguards and an effective local response if problems arise. States have such systems in place.

Insurers, agents, and brokers also must accept responsibility for maintaining a competitive and fair marketplace by reporting business practices that appear to be harmful, anti-competitive, or unethical to state regulators. Preventing and correcting market conduct problems requires that regulators and responsible business participants work together toward a common goal of strengthening stability and fairness in the marketplace. We achieve such stability through extensive daily monitoring of solvency, review of rates and policy forms, and evaluating market behavior.

State Insurance Regulators: "Cops on the Beat"

An example of recent collaboration between state regulators and attorneys general is the effort over the past two years to address wrongdoing and potential conflicts of interest associated with broker compensation. In October 2004, then-New York Attorney General Eliot Spitzer filed a civil complaint against a large brokerage firm after months of investigation by the attorney general and more than a year of analysis by the New York Insurance Department. The civil complaint, which included claims based on violations of New York antitrust law, unfair business practice law, and common law fraud, has resulted in a number of guilty pleas on criminal charges of fraud related to bid-rigging. The charges stemmed from contractual and implied arrangements between insurers and brokers in which the insurer pays extra commissions to the broker based on a number of factors, such as the loss ratio or retention of business placed through the brokerage firm. These commissions were in addition to regular sales commission, and often based on the performance of the insurer's entire book of business with an individual broker. Although these types of contingent commissions have been commonplace for more than a century, allegations of "rigged" competition among certain brokers and carriers emerged. Additionally, there were allegations that brokers would freeze out insurers with less favorable commission arrangements, regardless of whether the insurance fits a customer's needs. In terms of law enforcement and insurance regulation, this conduct constitutes fraud, an unfair business practice, and a violation of state antitrust law.

Without admitting or denying the allegations against them, five of the nation's top brokers entered into consent agreements with a number of attorneys general and state insurance departments. The agreements establish settlement funds ranging from $27 million to $850 million, which are available to policyholders who release the brokers from any liability associated with the settlements.

State experience with the business of insurance is long-standing. Existing state consumer protection, antitrust, and unfair trade practice laws provide necessary tools to help stop anti-competitive conduct. If Congress intends to provide federal authority to police for antitrust violations, then provisions for federal-state collaboration should be part of any legislation because the states have policed this beat longer.

Conclusion

A priority of state insurance regulators is to protect consumers. We recognize that insurance is a unique financial guarantee product that is essential to protecting not just the American economy, but also the most cherished personal effects of individual consumers.

It is part of the social fabric and financial safety net that enables citizens, small businesses, and global corporations to move forward each day with confidence.

State regulation of the business of insurance under the limited federal antitrust exemption granted by the McCarran-Ferguson Act has protected consumers for over 60 years, as it did for many years preceding the Supreme Court's decision in the *Southeastern Underwriters Ass'n* case. 322 U.S. 533 (1944). We have used that time to sharpen market supervision and enforcement tools to promote a lawful and competitive marketplace for insurance companies. Although insurance products generally have been widely available and competitive throughout the United States, state regulators do and will continue to act when necessary to correct market imbalances by using our authority to mandate insurance coverage and appropriate rates.

The NAIC stands ready to work with this Committee and the 110th Congress to examine as a separate and distinct policy issue whether a targeted boost in existing federal enforcement power against bad actors in certain alleged anti-competitive activities would complement strong state regulatory authority—not compete against it.

Thank you.

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Statement of Senator Sheldon Whitehouse
Hearing before the
Senate Judiciary Committee
on
"The McCarran-Ferguson Act and Antitrust Immunity:
Good for Consumers?"
Wednesday, March 7, 2007

Thank you, Mr. Chairman. I am a firm believer in the principles underlying our antitrust statutes, and I value the efforts of the Federal Trade Commission to shield consumers from the harm that anti-competitive behavior inflicts. Americans have a right to be protected from market distortions caused by illegal cartels, price fixing, anti-competitive mergers, and other abuses.

In some areas of the health care arena, however, antitrust laws distort an already imbalanced marketplace, and aid the immense corporation at the expense of the individual provider. While the nation has seen health insurers and managed care organizations bank record profits, impose huge premium increases, and enter into over 400 mergers in the past ten years, the FTC has been busy with roughly 28 actions against *physician* entities for anticompetitive conduct since 2002. Ironically, physicians, arguably the least consolidated component of the health care industry, are most constrained by antitrust concerns.

The problem is this: a giant health insurer, by operating within its huge corporate structure, can strategize to control physicians' fees with impunity under antitrust laws. But when even a few doctors engage in a parallel discussion to try to defend against such practices, they quickly risk an antitrust violation simply because they lack an equivalent overarching corporate structure. This unbalanced treatment of the provider community is an unintended consequence of our antitrust laws, with pernicious health care effects.

We must revisit the application of antitrust laws in the health care sector, because this sector is fundamentally different than other private sector markets regulated by the FTC. In the health care system, it is only through collaborative efforts that we can enhance quality of care, facilitate information exchange, and control costs. Individual providers cannot effectively and efficiently make these advances on their own. Even David Wales, Deputy Director of the FTC's Bureau of Competition, when before this Committee on September 6, 2006, acknowledged that joint conduct by physicians is not, by definition, anti-competitive.

Currently, the FTC allows physician cooperation in only two ways: financial integration with risk-sharing agreements, or through clinical integration. This standard is too limited. It hurts providers, it hurts patients, and it hurts the system as a whole. I look forward to working with you, Mr. Chairman, and all my colleagues on the Committee, to make the health care marketplace fairer for all involved parties.

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